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Report to the Chairman, Subcommittee on Conservation, Credit, and Rural Development, Committee on Agriculture, House of Representatives

November 1987

CROP INSURANCE

COMPLETED

Overpayment of Claims by Private Companies Costs the Government Millions

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GAO

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Resources, Community, and
Economic Development Division

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November 20, 1987

The Honorable Ed Jones
Chairman, Subcommittee on Conservation,
Credit, and Rural Development
Committee on Agriculture
House of Representatives

Dear Mr. Chairman:

Pursuant to your request of December 17, 1986, this report discusses the problems we found in the Federal Crop Insurance Corporation's oversight and control of the loss adjustment practices of private reinsured companies. The report contains recommendations to the Secretary of Agriculture directed at (1) requiring the Manager of the Corporation to improve the oversight and control process and (2) assuring that the Corporation is reimbursed for overpaid claims.

Major contributors to this report are listed in appendix VI.

Sincerely yours,

J. Dexter Peach

J. Dexter Peach
Assistant Comptroller General

Executive Summary

Purpose

The U.S. Department of Agriculture's (USDA) Federal Crop Insurance Corporation (FCIC) insures farmers against unavoidable losses due to adverse weather, insects, and crop disease. Prior to 1981 the program only covered selected crops in certain counties. The Federal Crop Insurance Act of 1980 changed this by calling for an expanded national program. The act also called for involvement of the private sector in the program, authorized a reinsurance program under which FCIC would reinsure private companies' risks, and required that the program be actuarially sound—with premium income covering payments for losses.

While FCIC has increased the scope of the program and the involvement of private companies, for fiscal years 1982-1986, indemnity payments have exceeded premium income by about $1 billion. Total indemnity payments have amounted to about $3 billion. Private companies reinsured by FCIC have been responsible for $1.5 billion of that amount.

In response to a congressional request, GAO reviewed the loss adjustment procedures followed by reinsured companies, which accounted for about 80 percent of FCIC's sales in 1986, to determine whether overpayments had occurred. In addition, GAO compared the reinsured companies' control over their loss adjustment process with FCIC's control over the policies it sells directly.

Background

Prior to the 1980 act, crop insurance was sold and serviced primarily by FCIC employees. Currently, FCIC relies on private reinsured companies and master marketers. Reinsured companies sell and service crop insurance policies under their own names and adjust losses when a claim is made. They are reinsured by FCIC against most of the losses incurred. Master marketers sell and service policies directly on FCIC's behalf. FCIC is directly responsible for all losses and for adjusting claims on the policies sold.

The cost of federal crop insurance to farmers is determined largely by the program's loss experience. Therefore, accurately adjusting claims for crop losses is vital not only to avoid wasting government funds but also to provide farmers with crop insurance at affordable rates. GAO's review focused on determining whether the loss claims of reinsured companies were accurate.

Results in Brief

Loss adjustments done by private reinsured companies, with minimal oversight by FCIC, resulted in millions of dollars in overpayments by FCIC.

Of the $9.4 million in 1984-85 claims reviewed, GAO found that $3 million, or 31 percent, were overpayments. The reviewed claims involved three crops in five states. Because the errors identified were so consistent and frequent, GAO believes they are indicative of a nationwide problem. For example, in following up nationally on one type of error—paying claims for losses due to drought on irrigated farms—GAO found that overpayments of about $18 million may have occurred during the 1984-86 period. With FCIC paying claims of about $3 billion during the 1982-86 period, t e potential for lowering government costs and farmer premiums is grea While GAO also found problems with losses adjusted by FCIC, they are of a much smaller magnitude than those adjusted by the reinsured companies.

Principal Findings

Reinsured Company Loss Adjustment Is Costing the Government Millions of Dollars

With the assistance of FCIC loss adjusters, GAO reviewed 134 claims adjusted by reinsured companies for crop years 1984 and 1985 and found that

- 127 claims, or 95 percent, were adjusted incorrectly;
- 113 of the incorrectly adjusted claims resulted in overpayments of nearly $3 million; 14 resulted in underpayments of about $32,000;
- for the $9.4 million in claims payments, the net overpayment rate was 31 percent;
- there was an average of two errors per claim;
- while the underpayments involved relatively small amounts, 63 percent of the overpayments were for $10,000 or more; and
- many of the errors made by claimants and reinsured companies were so obvious as to appear to have been intentional—14 claims have already been referred to the Department's Office of Inspector General for further investigation. (See ch. 2.)

FCIC Loss Adjustment Errors on Claims Are Frequent but Not Costly

GAO also reviewed 37 claims adjusted by FCIC employees and found that

- 23 (or 62 percent) contained procedural errors, but the net overpayment amounted to only about $19,000, or 1.1 percent, of the $1.7 million in indemnities paid and
- there were 33 procedural errors, an average of less than one per claim. (See ch. 3.)

Inadequate FCIC Oversight and Control Over Reinsured Companies

Until recently, FCIC has exercised little oversight of reinsured companies to ensure that controls over loss adjustment are in place and effective. Further, FCIC does not verify premium and loss information submitted by the companies, nor does it adequately screen claims for obvious errors prior to payments. During the period 1984-86, GAO found, for example, 3,846 claims adjusted by reinsured companies totalling $17.9 million with drought cited as the cause of loss on irrigated farms. Yet, according to FCIC rules, drought on an irrigated farm is an uninsurable cause of loss. In these cases, whether drought was the actual cause of loss or whether the cause of loss was incorrectly identified in the documents provided to FCIC by the reinsured companies, FCIC should have verified the validity of the claims prior to paying them.

The creation of a compliance division in August 1986 was FCIC's first attempt to establish some degree of systematic oversight and control over reinsured companies. Although this and other actions FCIC has taken to increase its oversight of reinsured companies' activities are steps in the right direction, much more needs to be done, particularly in regard to collecting identified overpayments. (See ch. 4.)

Recommendations

GAO makes several recommendations to the Secretary of Agriculture to improve the quality of the loss adjustment practices of reinsured companies and for FCIC to acquire the needed financial and programmatic controls over the activities of the reinsured companies. (See ch. 5.)

Agency Comments and GAO's Evaluation

FCIC agreed with many of the findings, conclusions, and recommendations in the report but disagreed with others. For the most part, FCIC did not disagree with GAO's findings on the individual claims review which support the basic findings of the report. Further, FCIC is planning to or has already begun to implement most of GAO's recommendations. FCIC's comments are addressed in detail in various chapters of the report and in appendix V.

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Contents

Executive Summary		2
Chapter 1 Introduction		8
	Purpose, Objectives, and Management of the Federal Crop Insurance Corporation	8
	Objectives, Scope, and Methodology	11
Chapter 2 Inadequate Loss Adjustment by Reinsured Companies Is Costing the Government Millions of Dollars		14
	FCIC's Loss Adjustment Process	14
	Claims Adjusted by Reinsured Companies Have Frequent and Costly Errors	16
	Types of Loss Adjustment Errors—Some Were Blatant	18
	Referral of Cases to the USDA Office of Inspector General for Investigation	22
	Agency Comments and Our Evaluation	22
Chapter 3 Loss Adjustment Errors on Master Marketers' Claims Are Frequent but Not Very Costly		24
	Errors Found Were Frequent but Not Very Costly	24
	Agency Comments and Our Evaluation	27
Chapter 4 FCIC Does Not Have Adequate Oversight and Control Over Reinsured Companies		29
	Reinsured Companies' Oversight and Control of the Loss Adjustment Process Are Ineffective	30
	FCIC's Oversight Over Master Marketer Claims Is More Effective	32
	FCIC Does Not Screen Reinsured Claims for Obvious Errors	34
	FCIC Has Only Recently Begun to Systematically Review the Operations of Reinsured Companies	36
	Agency Comments and Our Evaluation	39

Chapter 5 Conclusions and Recommendations

Conclusions 42
Recommendations to the Secretary of Agriculture 42
Agency Comments and Our Evaluation 43
44

Appendixes

Appendix I: Additional Examples of Reinsured Claims Where Program Eligibility Was Not Met 48
Appendix II: Additional Examples of Reinsured Claims Where Production Guarantee Was Wrong 50
Appendix III: Additional Example of Reinsured Claims Where Actual Production Was Wrong 52
Appendix IV: Results of Review of Claims Adjusted by FCIC, by State and Crop 53
Appendix V: Comments From the Federal Crop Insurance Corporation 54
Appendix VI: Major Contributors to This Report 72

Tables

Table 2.1: Results of Review of Claims Adjusted by Reinsured Companies 17
Table 2.2: Size of Overpayments Made by Reinsured Companies 17
Table 2.3: Frequency of Errors Found Regarding Determination of Eligibility, Production Guarantee, Actual Production, and Indemnity Due 18
Table 3.1: Size of Overpayments Made by FCIC on Master Marketer Policies 24
Table 3.2: Errors by Major Elements in the Loss Adjustment Process 25

Abbreviations

ASCS	Agricultural Stabilization and Conservation Service
CHIAA	Crop Hail Insurance Actuarial Association
FCIC	Federal Crop Insurance Corporation
GAO	General Accounting Office
LAC	loss adjustment contractor
NCIA	National Crop Insurance Association
OIG	Office of Inspector General
USDA	United States Department of Agriculture

Introduction

In addition to uncertain economic conditions, American farmers face many uncontrollable natural hazards that can prevent planting or destroy crops. Crop insurance provides protection to agricultural producers from losses caused by unavoidable disasters, such as insects, disease, fire, hail, drought, floods, freezing, and wind. The U.S. Department of Agriculture's (USDA) Federal Crop Insurance Corporation (FCIC), a government-owned corporation, was created in 1938 to promote the national welfare by improving the economic stability of agriculture through a sound program of federal crop insurance.

Before 1980 the crop insurance program operated on a limited basis, covering certain commodities and selected counties. For example, in the late 1970's the program covered as many as 27 commodities in about 1,700 of the country's 3,000 counties. The Federal Crop Insurance Act of 1980 (Public Law 96-365) called for an expanded crop insurance program by authorizing a subsidized all-risk, all-crop, nationwide program.

Since passage of the 1980 act, FCIC expanded its insurance coverage to include about 40 crops in about 3,000 counties across the United States. During this period, however, FCIC experienced and is still experiencing financial difficulties. From 1982 through 1986, insurance claims (indemnities) totaled about $3 billion compared with premium income of about $2 billion. FCIC has paid out $1.55 in claims for each $1 of premium income earned.

Purpose, Objectives, and Management of the Federal Crop Insurance Corporation

The 1980 act provides for an insurance program for agricultural producers to protect their production investment against essentially all unavoidable risks. The act requires that the program be operated on an actuarially sound basis with premium income sufficient to cover losses and to establish, as expeditiously as possible, a reasonable reserve against unforeseen losses. Also, the 1980 act requires that FCIC shall, among other things

- use the private sector, to the maximum extent possible, to sell and service crop insurance policies and
- provide a program of reinsurance (whereby part or all of the risk is transferred from the original insurer to another party), to the maximum extent practicable, to begin not later than with the 1982 crops.

Program Delivery

Prior to the 1980 act, FCIC sold and serviced crop insurance policies using its own employees, employees of USDA's Agriculture Stabilization

and Conservation Service (ASCS), and a small number of independent agents. FCIC employees then adjusted claims for losses. In implementing the expanded insurance program under the 1980 act, FCIC believed that heavy reliance on the private sector would be necessary in order to reach a high level of participation in the program. Moreover, the shift to the private sector was viewed as being in accordance with congressional intent of the act. The 1980 act states that FCIC should "... to the maximum extent possible ... contract with private insurance companies ... and encourage the sale of federal crop insurance through licensed private insurance agents and brokers ...."

Accordingly, FCIC developed an Agency Sales and Service Agreement and a Standard Reinsurance Agreement. Under the former agreement, an insurance company or agency (commonly referred to as a master marketer) agrees to sell and service FCIC insurance policies. FCIC compensates the master marketers for their services on a commission basis—currently 15 percent of premiums. FCIC maintains responsibility for adjusting losses (the assessment and determination of the amount and cause of the loss in crop yield) on the policies sold by master marketers. Also, FCIC incurs all losses on policies sold by master marketers and realizes all gains.

Under the reinsurance agreement, private insurance companies sell, service, and adjust the losses on policies they sell under their own names. The reinsured companies are also compensated for administrative, operating, and claim adjustment expenses—currently 30 percent of the companies' total premiums—plus a reimbursement for a portion of any state premium taxes paid. Unlike the master marketer delivery system, FCIC provides the companies with reinsurance coverage as protection against most of the risk that could result from losses incurred by the companies and shares in any gains or losses with the companies.

Under the current agreement, reinsured companies are responsible for a maximum underwriting loss of 15.375 percent of premiums on the business they retain.[1] FCIC pays all losses on a claim above that amount.

Neither agreement, however, provides for assigned exclusive sales territories. Therefore, the master marketers and reinsured companies compete with each other for producers' insurance business. In areas not

[1]The reinsured companies cede (transfer) a portion of their business to FCIC. They do not share in underwriting gains and losses with FCIC on the business that is ceded to FCIC.

served by either delivery system, ASCS sells and services the federal crop insurance through its county offices.

From 1982 through 1986, premium income from policies sold by master marketers totaled about $895 million and indemnities totaled about $1.5 billion. During the same period, premium income on policies sold by reinsured companies totaled about $1.1 billion, and indemnities about $1.5 billion. In 1986 reinsured companies accounted for about 79 percent of the $378 million of premium income generated under the program and master marketers about 21 percent. In 1987, it is expected that reinsurance will account for 90 percent of total insurance sold.

Program Funding

FCIC receives funds from three primary sources—premium income from producers purchasing insurance policies, the issuance of capital stock, and federal appropriations. The 1980 act authorizes FCIC to issue and sell $500 million in capital stock, which is to provide working capital and a reserve to cover losses when premium income and/or reserves are insufficient. Because of its large losses, FCIC had issued and sold all of the capital stock to the U.S. Treasury as of August 1985. In addition, FCIC borrowed $113 million from the U.S. Treasury in fiscal year 1985 and $450 million from USDA's Commodity Credit Corporation at various times through September 1986.

Insurance Coverage

Federal crop insurance can help mitigate the effects of crop losses caused by unavoidable natural hazards, but it does not insure profit for the producer or cover avoidable losses resulting from negligence or failure to observe good farming practices. Crop insurance is generally provided at three coverage levels—50, 65, or 75 percent of the farm's recorded or appraised average yield—and at three different target price elections (dollar value per unit of production), with one being not less than 90 percent of the projected market price for the crop insured. In all, the producer has nine insurance options. The insurance guarantees the producer a certain amount of coverage for production—in bushels or pounds—per acre. Farmers' premiums are due at time of harvest. If a farmer is paid for a loss on a claim, the premium due is deducted from the claim payment made.

To understand how crop insurance operates, assume that a farmer with an average production of 100 bushels of corn per acre selects a 65-percent production guarantee option and a $2.70 per bushel payment level.

If a natural disaster occurs and the actual production drops to 20 bushels per acre, the farmer would have an insured loss of 45 bushels (65 percent of 100 bushels less the 20 bushels actually produced). FCIC would pay the farmer $121.50 ($2.70 x 45 bushels) for each acre insured.

Objectives, Scope, and Methodology

Our review was conducted at the request of the Chairman, Subcommittee on Conservation, Credit, and Rural Development, House Committee on Agriculture.[2] The overall concerns of the requester were whether or not the program is providing protection needed by farmers at an affordable cost. This concern was based on the overall increasing cost of the program, which appears to coincide with the increasing market share of the reinsured companies, and the apparent lack of FCIC oversight and control over loss adjustment practices being used by reinsured companies. In response to these concerns, we determined (1) whether reinsured companies were adjusting claims for losses in accordance with procedures and methods consistent with those used by FCIC and (2) what the reinsured companies' oversight and control over the loss adjustment process was and compared it with FCIC's oversight and control over losses adjusted on policies sold by master marketers (referred to in this report as master marketer claims).

To accomplish our first objective, we judgmentally selected for review 134 large claims. Each claim was for over $20,000.[3] In total, 12 different reinsured companies were involved. The claims filed by farmers and adjusted by the reinsured companies were for crop years 1984 and 1985 (the most recent years for which complete claim data were available from FCIC).[4] For the respective years, the number of total claims over $20,000 was about 3,500 and 4,400. We began by reviewing 1984 claims in Mississippi because the allegations of erroneously paid claims were first made about claims in that state, and then expanded our review to include 1985 claims in California, Louisiana, Montana, and Oklahoma. The four additional states were selected based on geographic dispersion, type of crop, and total amount of claims paid. Eighty-four of the 134 claims we reviewed involved soybeans because soybean claims accounted for about 55 percent of total FCIC indemnities during the

[2]The review was initially requested by Representative Webb Franklin of Mississippi in June of 1986, who subsequently did not return to the 100th Congress.

[3]One soybean claim we reviewed involved a companion contract for the landowner that was under $20,000 but was included in our overall statistics.

[4]Crop year as defined is the calendar year in which a crop normally is harvested.

period 1981-1985. We selected 25 wheat claims because wheat claims represented about 18 percent of total FCIC indemnities for the same period.[5] We selected 25 grape/raisin claims in California because grape/raisin claims represented about 69 percent of total indemnities paid in the state in 1985. Also, in selecting specific claims to review in each state, we tried to select claims from contiguous counties to minimize the logistical problems of traveling around the state to gather the information needed, particularly crop production data, to evaluate the accuracy of the adjusted claims.

To evaluate the accuracy of the adjusted claims, we enlisted the assistance of FCIC staff certified to adjust losses on FCIC crop insurance claims. Working with these technical experts, we obtained all relevant paperwork in support of each claim and then recomputed the amount that should have been paid on each of the 134 claims in accordance with the loss adjustment procedures and methods used by FCIC. We readjusted the loss on each claim and compared the results with the claim amounts adjusted by the reinsured companies to determine whether an overpayment or underpayment occurred. In readjusting the losses, where necessary, we discussed the claim with the insured, the agent who sold the policy, the reinsured company loss adjuster, and third parties, such as grain elevator operators and grape packers/shippers, with knowledge bearing on the claim. Also, we presented our individual claim review results to the reinsured companies and discussed our findings with their representatives. Their comments were taken into account throughout this report and are reflected as appropriate. In addition, at the conclusion of our audit we provided FCIC management with detailed information on each of the cases included in our review.

To meet our second objective, we met with representatives of each of the reinsured companies that had adjusted the losses on our sample claims to obtain information on their oversight and control of the loss adjustment process. We also obtained information on FCIC's oversight and control of the loss adjustment process through (1) discussions with FCIC headquarters officials and representatives of FCIC's field operations offices that have responsibility for monitoring loss adjustment activities in each of the five states included in our review and (2) review of FCIC loss adjustment manuals and handbooks. We then compared the reinsured companies' procedures with those used by FCIC in adjusting its claims on master marketer sales.

[5]One wheat claim we reviewed also included barley as part of the claim.

Our work at the reinsured companies was limited primarily to discussing the companies' controls over the loss adjustment process with key company officials and to reviewing company policies and procedures relating to the guidance and training they provide their loss adjusters.

Also, in performing our review we wanted to determine whether the loss adjustment process used by FCIC actually resulted in more or less accurate claims adjustment than the process being used by the reinsured companies. To accomplish this we reviewed a sample of 37 master marketer claims adjusted by FCIC in the five states that we visited. These claims accounted for about 22 percent of the 171 total claims we reviewed. This is approximately the same four-to-one ratio of master marketer claims to the number of reinsured company claims paid by FCIC in 1985. The master marketer claims reviewed were the largest claims in the same counties where we reviewed reinsured company claims. We used the same FCIC expert assistance and the same methodology in readjusting losses on the master marketer claims that we used in readjusting losses on the reinsured company claims. Also, we discussed our results with officials of the applicable FCIC field offices, and their comments are reflected in the report as appropriate.

In addition to our work in direct response to the concerns of the requester, we reviewed FCIC's written policies and procedures for adjusting claims and its reinsurance agreements with the reinsured companies. We also discussed previous and ongoing audits of FCIC's claims adjustment process with officials of USDA's Office of the Inspector General (OIG). At FCIC's headquarters in Washington, D.C., we discussed the results of our work and FCIC's ongoing and planned oversight of the reinsured companies and the reinsured companies' loss adjustment process.

We conducted our work between May 1986 and July 1987 in accordance with generally accepted government auditing standards.

Inadequate Loss Adjustment by Reinsured Companies Is Costing the Government Millions of Dollars

FCIC annually pays hundreds of millions of dollars in claims determined by a loss adjustment process that is performed by the reinsured companies and by FCIC-supervised contractors on policies sold by master marketers. Reinsured companies are required to adjust claims using procedures and methods consistent with those used by FCIC. The loss adjustment process is key to the accurate determination of losses; therefore, the quality of its execution is crucial to producers, FCIC, and the taxpayer. We found that the reinsured companies are simply not getting the job done.

Our review of 134 FCIC insurance claims adjusted by reinsured companies revealed overpayments of about $3 million, or 31 percent of the $9.4 million paid. These overpayments, the vast majority of which FCIC is responsible for, occurred because the loss adjustment procedures and methods used by the reinsured companies were neither consistent with those used by FCIC nor effective in preventing errors. Further, while we judgmentally selected our sample from five states, the identified errors (an average of two per claim) were so frequent and consistent that we believe they are indicative of a nationwide problem. In addition, we found that many of the errors by claimants and reinsured companies were so blatant that they appear to have been intentional.

FCIC's Loss Adjustment Process

The loss adjustment process for both reinsured companies and master marketers compares the amount of production an insured farmer actually experiences with the amount of production guaranteed by the crop insurance policy. Essentially, according to FCIC procedures, the process can be divided into four major elements—the determination of (1) program eligibility—whether a person is eligible to get crop insurance, (2) the amount of production that is guaranteed under each policy—called the production guarantee, (3) the amount of actual production, and (4) the amount of indemnity due. Each selling agent has prime responsibility for determining eligibility and establishing the production guarantee. However, the loss adjuster has prime responsibility for determining actual production and the indemnity due on each claim. In addition, the adjuster is responsible for verifying that the determination of program eligibility and that the production guarantee are correct. The four major elements involved in adjusting a claim are described below. The requirements discussed under each element are from pertinent FCIC manuals.

Determination of eligibility. In determining whether a producer applying for crop insurance is eligible, the sales agent must ensure that the acreage to be insured is classified as insurable by FCIC; the insured has an

insurable interest in the crop as landlord, owner-operator, or tenant; and the crop is planted by the final plant date allowed by the policy. Further, prior to a prescribed deadline for the particular crop being insured, the producer must submit an FCIC acreage report that sets forth such information as the location and number of acres to be planted, the insurance coverage desired, and other related information.

Determination of production guarantee. The sales agent must consider four major issues in determining a producer's production guarantee: the number of acres insured, the farming practice used, the land's productive capacity as determined by FCIC, and the cause of the crop loss. The agent should verify that the number of acres specified on a producer's insurance application is accurate by either actual measurement or reviewing aerial maps and/or acreage reports maintained by the ASCS county officer.[1]

The farming practice determination is important because it affects the guaranteed per-acre production of the farm. The type(s) of farming practice assigned to a policy varies by area and crop but generally depends on whether the crop is irrigated or nonirrigated, planted in rows or broadcast (scattered), and planted after the harvesting of another crop. The agent should verify the farming practice used through either a visit to the farm or review of ASCS acreage reports certified by the producer.

Land classified by FCIC as insurable is assigned a risk factor based on the land's productive capacity. The agent determines the applicable risk factor assigned to the applicant's farm by reviewing actuarial tables showing the risk factor assigned to classified acreage in the county or, when available, by checking an FCIC listing of risk factors assigned to individual farms.

At the time of adjustment, the adjuster should determine whether the cause of loss is insurable. An uninsurable cause of loss, such as wind damage for a raisin crop or drought damage on an irrigated farm, could result in a portion of or the entire claim being disallowed.

Determination of actual production. When a farmer notifies the company of a claim, the adjuster is responsible for determining the producer's actual production. Actual production is the total number of

[1] ASCS requires producers that participate in certain farm programs to submit acreage reports (ASCS Form 578) to its county officer.

bushels or tons of crop harvested, plus any potential production from unharvested acres, less normally minor adjustments to account for moisture, foreign matter, and other impairments to crop quality.

To arrive at a determination of the amount of actual production, the adjuster should obtain the producer's records to determine the harvested production sold or stored for sale at a later date. Producers are required to notify the insurance company of a claim before harvesting the entire crop so that the adjuster can visit the farm to appraise the production. If production reported by the producer appears unreasonable based on production of comparable farms, the adjuster is required to take additional steps to verify production. One step FCIC requires under such circumstances is to canvass entities, such as grain elevators or processors, where the producer may have sold the crop. Any additional production the adjuster finds that can be attributed to the insured's farm is included in the determination of actual production. Finally, applicable quality adjustments are made to arrive at a final production figure.

Determination of indemnity. When the adjuster determines that the amount of actual production is less than the amount of production guaranteed by the policy guarantee due to an insurable cause of loss, the indemnity must be determined. This is basically done by multiplying the difference between the actual production and the amount of the production guaranteed by the price option selected by the producer at the time the insurance policy is purchased. However, if the insured has less than a 100-percent interest in the crop, the indemnity is reduced to reflect the percentage of the insured's interest. Further, the indemnity is reduced by the cost of the insurance premium to arrive at the actual payment to the insured.

Claims Adjusted by Reinsured Companies Have Frequent and Costly Errors

Of the 134 claims we reviewed, 127, or about 95 percent, were not adjusted using FCIC's methods and procedures. Of the 127 claims adjusted improperly, 113 resulted in overpayments of about $3 million, and 14 resulted in underpayments of about $32,000. Thus, had all of the 134 claims been adjusted properly, FCIC payments would have totaled about $6.5 million rather than the $9.4 million that was actually paid. In other words, for our sample, $1 of every $3 should not have been paid. Table 2.1 shows the detailed results of the 134 claims we reviewed by state and crop.

Table 2.1: Results of Review of Claims Adjusted by Reinsured Companies

State and crop	Total claims reviewed		Claims overpaid		Claims underpaid	
	Number	Amount	Number	Amount	Number	Amount
California--grapes and raisins	25	$1,359,616	18	$640,558	6	$19,483
Louisiana—soybeans	26	2,161,134	20	464,790	5	7,711
Mississippi—soybeans	38	1,384,022	37	933,589	1	317
Montana—wheat	25	3,310,719[b]	19[b]	250,560[b]	2	4,478
Oklahoma—soybeans	20	1,195,369	19	646,048	0	0
Total	**134**	**$9,410,860**	**113[a]**	**$2,935,545**	**14[a]**	**$31,989**
Percentage of total claims reviewed	100	100	84.3	31	10.4	0.3

[a]Combined error rate is 95 percent (84.3 percent for overpayments and 10.4 percent for underpayments).

[b]One claim also involved an indemnity of $563,780 for barley that was also erroneously paid but is not reflected in our overall statistics.

Source: Our analysis of claims reviewed on policies sold by reinsured companies.

Although FCIC procedures are designed to assure that the determination of losses is reasonably accurate, the types and frequency of errors we found clearly indicate that the reinsured companies were not adequately following loss adjustment procedures and methods consistent with those of FCIC. The identified underpayments involved relatively small amounts, but about 63 percent of the overpayments were for $10,000 or more. (See table 2.2.)

Table 2.2: Size of Overpayments Made by Reinsured Companies

Amount of overpayments	Number overpaid	Percent of total
Under $500	9	8
$500 to $999	6	5
$1,000 to $9,999	27	24
$10,000 to $29,999	34	30
$30,000 to $49,999	19	17
$50,000 to $99,999	10	9
$100,000 to $199,999	6	5
Over $200,000	2	2
Total	**113**	**100**

Source: Our analysis of claims reviewed on policies sold by reinsured companies.

Types of Loss Adjustment Errors—Some Were Blatant

We found errors on the claims adjusted by the reinsured companies in each of the four major elements of the loss adjustment process. As table 2.3 shows, we found 269 instances where correct procedures were not followed on the 134 claims reviewed, an average of over 2 errors per claim.

Table 2.3: Frequency of Errors Found Regarding Determination of Eligibility, Production Guarantee, Actual Production, and Indemnity Due

Loss adjustment element	Number of errors	Percent of total
Determination of eligibility	8	3
Determination of production guarantee	144	54
Determination of actual production	98	36
Determination of indemnity due	19	7
Total	**269**	**100**

Source: Our analysis of claims reviewed on policies sold by reinsured companies.

A discussion of the types of errors we found and examples of claims that demonstrate the errors follow. In many cases we found the errors to be so blatant they seem to have been an intentional attempt to inflate the amount of indemnity payments made.

Determination of Eligibility

Of the 134 claims reviewed, we found 8 claims where producer eligibility was not determined properly. We found one case where the producer's land had not been classified by FCIC; two cases where the insured did not submit an acreage report by the reporting deadline; two cases where the insured had no insurable interest in the crops; and three cases where the producer did not plant the crop by the date required. As illustrated in the examples below, significant overpayments can result from these kinds of errors.

Example A. A soybean grower in Oklahoma was ineligible for an indemnity because the entire farm was not classified as insurable by FCIC. Under FCIC rules, a farm must be classified to be insurable. Apparently, neither the reinsured company's sales agent nor the claims adjuster verified that the land being insured was insurable. As a result, an overpayment of $129,736 occurred.

The manager of the reinsured company in this case responded to our finding on this claim by stating that the farmer insured all of the acres in question under one farm serial number,[2] and this farm serial number

[2]Farm serial number is a numerical identification of the land contained in a given tract of farmland.

was classified by the field actuarial office of FCIC. Therefore, according to the manager, the agent sold the insurance correctly.

We disagree that the agent sold the insurance correctly. Although it is true that the farmer insured the acreage under a farm serial number that was classified by FCIC as insurable, neither the sales agent nor the adjuster verified that the acres actually insured were part of that farm. By reviewing ASCS records and discussing the claim with the insured, we found that only 289 of the 1,162 acres included in the claim were part of the farm serial number cited. Regarding the 289 acres found on the cited farm serial number, we found that only one section of the farm had been classified as insurable and, while a part of that farm, the acres were not included in the section of the farm deemed insurable by FCIC. Therefore, we believe that the entire claim payment of $129,736 is invalid.

Example B. A wheat grower in Montana did not submit an acreage report stipulating the number of acres and the crops to be insured by the last allowable filing date June 30, 1985. FCIC policy allows for the acceptance of a late-filed acreage report, but only after examination of the property by the agent to ensure that a normal crop can be expected. In this case, the acreage report was not filed until July 19, 1985, and we found evidence in the policy file that showed damage in the fields had been documented by the reinsured company's loss adjuster on both June 27 and July 5. The reinsured company agent, however, accepted the late-filed acreage report and thus insured a known liability. This was in direct violation of FCIC policy. As a result, the insured received a $68,713 indemnity payment for a loss that was uninsurable.[3]

The manager of the reinsured company in this case responded to our finding on this claim by stating that the reinsured company has the option to accept liability when an acreage report is submitted after the required filing date. He said that the company chose to accept the late acreage report because the reason the report was late was not the insured's fault, but the fault of the county ASCS office.

The reinsured company manager is correct in that the crop insurance general policy provisions allow for the acceptance of a late-filed acreage report. However, the policy is clear that the reinsured company has a responsibility to make certain that conditions at the time the insurance liability is accepted indicate that the insured can expect a "normal" crop. This was not the case, however. The reinsured company knew at

[3]The claim also involved an indemnity payment of $563,780 for barley that was also uninsurable.

the time the late acreage report was filed that a normal crop would not be produced. Providing insurance coverage in such a situation resulted in insuring a known liability—a violation of FCIC policy, and an unsound practice in any insurance business. Further, the delay in obtaining the acreage report was not the fault of ASCS as asserted by the manager of the reinsured company. The company's files show that the acreage report was not filed by the producer until after the prescribed June 30 filing date. The files show that ASCS did not cause the acreage report to be filed late.

Additional examples of claims not meeting eligibility requirements can be found in appendix I. (See p. 48.)

Determination of Production Guarantee

Of the 134 reinsured claims reviewed, we found 96 claims with 144 errors in the establishment of the production guarantee. Specifically, we found 59 instances where the number of insured acres was incorrect; 27 instances where the farming practice was incorrect; 35 instances where the risk factor assigned to the land was incorrect; and 23 instances where other errors occurred, primarily where the cause of loss was uninsurable. Each error resulted in the production guarantee being either over- or understated, and in an over- or underpayment to the insured.

Example A. An error involving acreage determination is illustrated by a claim paid to an Oklahoma soybean grower. The claim was based on 897 planted acres. We determined from reviewing ASCS records and discussing the claim with the insured that the number of acres actually planted was 637.5. Further, 33.6 planted acres were not classified as insurable by FCIC. As a result, the claim was overpaid by $30,142. Apparently, neither the sales agent nor adjuster verified the number of acres or the insurability of the land.

The reinsured company manager agreed that the 33.6 acres were not insurable but disagreed that the total acres planted were overstated. However, he provided no support or basis for including the additional acreage in the claim. Therefore, we continue to believe the claim was overpaid by $30,142.

Example B. A soybean grower in Mississippi insured 215.7 acres under an irrigated farming practice. The crop was a complete loss, and the insured was paid $25,237, less a deduction for the premium due. However, the cause of loss was drought. Because, according to FCIC, drought

is an uninsurable cause of loss on an irrigated farm, the loss was uninsurable. Therefore, the amount due back to FCIC, including the premium, is $27,717.

The claims supervisor for the reinsured company in this case agreed with our finding on this claim.

Additional examples demonstrating errors in determining production guarantee can be found in appendix II. (See p. 50.)

Determining Actual Production

The amount of an insured's actual production is the total of harvested production, plus any appraised unharvested production, less any necessary adjustments for quality. Our review of the 134 reinsured claims disclosed that on 98 claims, the amount of actual production was determined incorrectly. We found uncounted production on 47 of the claims, and errors in the quality adjustment process on 51 of the claims. By including the uncounted production in the loss adjustment process, we reduced the amount of the indemnity due in 42 claims and eliminated the entire indemnity in five claims. Adjustments for moisture, foreign matter, and other factors that reduce the quality of the crop are normally minor.

Example A. A wine grape grower in California received $110,655 for a claim where the adjuster showed production as 15,910 lugs (boxes), which was below the production guarantee of 40,005 lugs. However, through a review of production records provided by the producer and additional records we found at a local grape packer, and discussions with the adjuster, we identified a total of 42,935 lugs of harvested production, which exceeded the guarantee. As a result, the entire indemnity payment of $110,655 was unwarranted.

The adjuster told us that he based his determination of the amount of actual production on a settlement sheet between the grower and the packer, which showed harvested production through September 14, 1985, and which was prepared by the packer at the direction of the grower. However, we know from the adjuster's notes in the case file that the adjuster was aware that harvesting of the grapes was continuing on September 16, 1985.

From the information available, we are unable to determine why all of the harvested production was not counted—either because of adjuster error or because the grower made a conscious effort to underreport his

production. The reinsured company in this case agreed with our finding and stated that the overpayment was not the result of adjuster error but because the grower underreported production.

An additional example demonstrating errors in determining actual production can be found in appendix III. (See p. 52.)

Determining Indemnity Due

The final step in the loss adjustment process is to determine the insured's indemnity. Once the production guarantee and the amount of actual production are determined, the adjuster should apply the price option to any difference and determine the insured's share or interest in the crop to arrive at the indemnity. However, in 19 of the 134 reinsured claims we reviewed, the insured's share was incorrectly determined, and overpayments were made.

Example A. A Mississippi soybean grower insured his crop and was paid an indemnity based on a 100-percent interest in the crop. However, in reviewing the ASCS acreage report, we found that the insured had certified that he had only a 70-percent interest in the crop. As a result, the insured's claim was overpaid $35,168.

We do not know why the loss adjuster failed to verify the insured's interest in the crop. However, the claims supervisor for the reinsured company agreed with us—based on the ASCS acreage report certified by the insured—that the claim was overpaid.

Referral of Cases to the USDA Office of Inspector General for Investigation

At the conclusion of our survey work in Mississippi, we met with representatives of the USDA Office of Inspector General (OIG) and the U.S. Department of Justice to discuss our findings. It was agreed that representatives of USDA/OIG would review our case files to determine if any warranted further investigation and, if so, they would accept those cases as referrals. Fourteen of our 38 survey cases were referred for investigation. We are continuing to work with the OIG on the results of our work in the four additional states.

Agency Comments and Our Evaluation

In commenting on this chapter of the report, FCIC said that prime responsibility for establishing production guarantees lies not with the loss adjuster at the time of loss as we stated but with the sales agent and the underwriting office at the time the policy is written. In this regard, FCIC

stated that the distinction is crucial in establishing accountability for loss adjusters.

We agree that responsibility lies with the selling agent and have changed the language in our report accordingly. However, the important point here, as FCIC notes, is not whether the agent or the loss adjuster is responsible for establishing the production guarantee but that it is properly determined and verified at the time of loss. As our report shows, of the 134 reinsured company claims reviewed, we found 96 with errors in establishing production guarantees.

FCIC took exception to case example B in the section dealing with "Determining Production Guarantees." (See pp. 20-21.) Its concern was that we had improperly denied a claim as uninsurable when FCIC policy would have dictated a reduction in coverage. In its comments on this case, FCIC described, in detail, proper procedures for adjusting claims involving irrigated vs. nonirrigated situations. These procedures would require reducing the guarantee level to the nonirrigated practice limit and adjusting the claim accordingly. Essentially, FCIC contended that we did not apply these procedures properly.

The example FCIC refers to in the report deals with drought as the cause of loss on an irrigated farm, which by FCIC's own policy is uninsurable. The example does not deal with the situation described in FCIC's comments involving irrigated versus nonirrigated land. In cases where we encountered this situation, the procedures identified in FCIC's comments are precisely the procedures we used.

Loss Adjustment Errors on Master Marketers' Claims Are Frequent but Not Very Costly

Thirty-seven claims on policies sold by master marketers were selected for review to provide a basis for comparing the loss adjustment practices of FCIC and the reinsured companies, as well as to assess the effectiveness of FCIC's quality control system over its own loss adjustment process. Unlike reinsured companies, master marketers have no responsibility to adjust claims on the policies they sell. Our review of those claims disclosed that 23 claims (or 62 percent) were not adjusted in accordance with FCIC policies and procedures, but resulted in net overpayments of only $19,356 on a total of $1.726 million (1.1 percent) in claims reviewed. Given the complexity of the loss adjustment process, we believe that the 1.1-percent overpayment is an acceptable error rate. Moreover, the overpayments on FCIC adjusted claims pale in comparison to those made on reinsured claims. We found that of the 23 claims adjusted improperly, 17 were overpaid by a total of $25,617, and 6 were underpaid by a total of $6,261. Thus, had the 37 claims been adjusted properly, FCIC would have paid a total of $1.706 million instead of the $1.726 million actually paid. (See app. IV, p. 53 for results on a state and crop basis.)

Errors Found Were Frequent but Not Very Costly

In contrast to the claims adjusted by the reinsured companies, where we found that about 63 percent of the overpayments were $10,000 or more, 9 (or about 53 percent) of the 17 master marketer claims were overpaid by less than $500, and the largest overpayment was $7,335. (See table 3.1.)

Table 3.1: Size of Overpayments Made by FCIC on Master Marketer Policies

Amount of overpayments	Number overpaid	Percentage of total
Under $500	9	52.9
$500 to $999	0	.0
$1,000 to $1,999	3	17.6
$2,000 to $2,999	3	17.6
$3,000 to $3,999	0	.0
$4,000 to $4,999	1	5.9
Over $5,000	1	5.9
Total	**17**	**100.0[a]**

[a]Because of rounding, percentages do not add to 100 percent.

Source: Our analysis of claims reviewed on policies sold by master marketers.

We found 33 errors on the 37 master marketer claims we reviewed, an average of less than one error per claim, compared with 269 errors, or

an average of over 2 errors per claim on the 134 reinsured company claims we reviewed. Also, in contrast to the reinsured company claims, where we found errors in each of the four major elements of the loss adjustment process, we found errors on the master marketer claims in only two of the major elements as shown in table 3.2.

Table 3.2: Errors by Major Elements in the Loss Adjustment Process

Major element	Number of errors	Percentage of total
Determining eligibility	0	0
Determining production guarantee	14	42
Determining actual production	19	58
Determining indemnity due	0	0
Total	**33**	**100**

Source: Our analysis of claims reviewed on policies sold by master marketers.

As table 3.2 illustrates, 19 (or about 58 percent) of the errors we found on the master marketer claims occurred in the determination of actual production. Of these 19 errors, 16 (or 84 percent) occurred in the quality adjustment step performed by the adjuster when determining actual production. These quality adjustment errors usually had a relatively minor dollar impact on the claim. For example, on one claim involving 1,027 bushels of soybeans in Louisiana, the adjuster made adjustments for the quality of the beans that reduced the amount of actual production to 914 bushels. However, after reviewing this claim with FCIC experts, we determined that the correct amount of actual production after appropriate quality adjustments was 965 bushels. The difference, 51 bushels, multiplied by the selected price option, $6.50 per bushel, results in an overpayment to the insured of $331.50.

Because almost 50 percent of the errors we found on the master marketer claims evolved from the quality adjustment process, and because these kinds of errors usually had a relatively small impact on the claim in terms of the amount over- or underpaid, the relatively small overpayment rate for the master marketer claims we reviewed is understandable.

Following are examples illustrating the types and dollar value of the nonquality adjustment errors we found on master marketer claims.

Determining Eligibility

For the 37 claims reviewed, we found no instances of errors in this element of the loss adjustment process.

Determining Production Guarantee

As previously stated, four elements are involved in establishing the production guarantee: determining the number of insurable acres, determining the farming practice, determining the risk factor(s), and determining whether the cause of loss is insurable. We found 11 instances where the number of insured acres was incorrect, 1 instance where the practice was incorrect, 2 instances where the risk factor was incorrect, and no instances where the cause of loss was uninsurable. An example of a master marketer claim involving each of the three types of errors follows.

Example A. A Mississippi soybean grower was paid for a claim based on 752.1 acres. However, we found that 38.5 of the acres were in another county and thus were not insurable on the same policy with the other 713.6 acres. FCIC requires separate policies to insure acreage in separate counties. As a result, the insurance paid on the crops lost on the 38.5 acres was in error; the insured was overpaid $1,613. The responsible FCIC field office director agreed with us.

Example B. The assigned farming practice was wrong on a Montana wheat grower's claim. He incurred a loss on all nine farm units covered by his insurance policy. On 1 of the units, all 13.1 acres were assigned a farming practice that was based on the land not being planted during the summer months (referred to as summer fallow). However, we found that a different farming practice should have been assigned to 3.7 of the acres in the unit because the acres were planted during the summer months (referred to as continuous cropping). The change in farming practice reduced the per acre guarantee from 33 to 14 bushels. The difference of 19 multiplied by the 3.7 acres involved and by the selected price option, $3.75 per bushel, equals a $264 overpayment. The responsible FCIC field office supervisor agreed with us.

Example C. An error involving the assigned risk factor occurred on a claim by a Mississippi soybean grower. The 511.6 insured acres were assigned a risk factor of 5 by the adjuster, which resulted in a production guarantee of 13,023.6 bushels. We found, however, that 81.9 of the acres should have been assigned a risk factor of 4. The error resulted in inflating the production guarantee by 403.8 bushels. The impact of this error, combined with the impact of the corresponding adjustment in the insurance premium, is a $2,304 overpayment. The responsible FCIC field office supervisor agreed with us.

Determining Actual Production

As mentioned earlier, this element of the loss adjustment process is where most of the errors on the master marketer claims occurred. Although we found 19 errors in determining the amount of actual production, only 3 of the errors involved uncounted production. The remaining errors involved the quality adjustment process and usually were minor in impact. The example that follows presents the largest overpayment of the three errors involving uncounted production.

Example A. An Oklahoma soybean grower received an indemnity payment of $1,162 based on losses on 86.3 acres. The claim was based on a production guarantee of 1,294.5 bushels and actual production of only 795.6 bushels. We found, however, that the farmer had planted an additional 93.2 acres under a late planting agreement with FCIC, and harvested production from the additional acres was not counted by the adjuster. We counted the additional production and increased actual total production to 2,063.2 bushels. By including the additional acres, the production guarantee also increased to 2,064.3 bushels. Thus, the production shortfall was only 1.1 bushels, and the insured was entitled to an indemnity before premium deduction of only $3.37. After making the premium adjustment to account for the additional acres planted under the late planting agreement, the insured owes FCIC $2,261. The FCIC technical expert working with us at this location reviewed and approved our analysis of the claim.

Determining Indemnity Due

The final determination of indemnity due requires a verification of the insured's share in the crop. For the master marketer claims, we found no instances of incorrect share determination.

Agency Comments and Our Evaluation

FCIC commented that the results of our review of master marketer claims may be understated because, in its opinion, review of higher dollar value claims would possibly have resulted in a higher overpayment rate. While FCIC's speculation may be accurate, we see no basis for it. Regardless of dollar value of a claim, the loss adjustment process is the same. Further, the master marketer claims we reviewed were the highest dollar value claims in the areas selected for our review. Consequently, we have not made any changes to the report on this point. FCIC also commented that even though master marketer claims receive increased supervisory reviews and roughly one of every three claims is reviewed twice, the 62-percent error rate found in our review demonstrates the complexity of the loss adjustment process. In our opinion, the 62-percent

error rate we identified represented minor procedural and administrative problems. Our report clearly points out that errors found on reinsured company claims were much more frequent and, more importantly, were much more costly than those found on master marketer claims.

FCIC Does Not Have Adequate Oversight and Control Over Reinsured Companies

Our belief that the errors we found in claims adjusted by reinsured companies are indicative of a nationwide problem is supported by the lack of necessary oversight and control by FCIC. While reinsured companies have increased their share of the insurance business from zero percent in 1980 to about 80 percent in 1986, FCIC had exercised no systematic oversight and control over their operation, until August 1986. This situation existed even though FCIC was paying for most of the reinsured company claims as well as reimbursing the companies for their loss adjustment activities. In addition to the lack of FCIC oversight and control of reinsured companies, the system of internal controls over the quality of the loss adjustment process by the reinsured companies themselves appears to be ineffective. As a result, costly, frequent overpayments in reinsured company claims have occurred.

On the other hand, FCIC's oversight and control over the loss adjustment process for master marketer claims is more effective. FCIC has exercised more stringent and direct oversight and control over its own loss adjustment activities since the beginning of the program in 1981. This hands-on approach to loss adjustment for all master marketer claims, we believe, has resulted in better performance of the master marketers' loss adjustment activities as indicated in the relatively minor amount of overpayments that we found on the claims included in our review.

Further, in addition to the overall lack of systematic oversight and control programs over reinsured companies, we found that FCIC failed to do basic checks of the accuracy of the data submitted by the reinsured companies as a basis for making payments. Specifically, FCIC does not screen claims on policies sold by reinsured companies for obvious errors prior to payment as it does for claims on policies sold by master marketers. This lack of screening has contributed to the substantial amount of overpayments made by FCIC on claims adjusted by reinsured companies.

In August 1986 FCIC began to move toward improved oversight and control of reinsured companies by establishing an organizational unit responsible for, among other things, systematically monitoring the loss adjustment activities of reinsured companies. Also, FCIC has taken and proposed some additional administrative actions that should help. However, much more needs to be done, particularly in regard to collecting the overpayments identified by its new unit and others.

Reinsured Companies' Oversight and Control of the Loss Adjustment Process Are Ineffective

During crop years 1984 and 1985, FCIC required the reinsured companies to have a system of oversight and control over the loss adjustment process but had no systematic oversight and control program of its own to check on the effectiveness and accuracy of the loss adjustment activities of reinsured companies. Until August 1986, it primarily relied on the reinsured companies to police themselves. Officials from each of the reinsured companies we reviewed told us that such a system was in place. However, the results of our claims review in chapter 2 demonstrates that excessive errors are occurring and the reinsured companies' oversight and control systems are ineffective in precluding the processing of erroneous claims.

Company Guidance to Adjusters

The written procedures and guidance the reinsured companies provided to loss adjusters appears to be adequate. All the reinsured companies included in our review told us that they use loss adjustment procedures and methods approved by FCIC. They use rates and rules manuals published by the Crop-Hail Insurance Actuarial Association (CHIAA), a clearinghouse for the crop insurance industry, and crop and field operations handbooks published by the National Crop Insurance Association (NCIA), a crop insurance industry association. One of the companies published its own handbooks, patterned after similar FCIC guidance. In addition, another company developed and used supplemental material to aid adjusters on setting up appointments with growers and conducting field inspections. We noted that the manuals and handbooks used by the companies were nearly identical to similar resources published and used by FCIC.

Company Provided Training

Although the training the reinsured companies told us they provide to loss adjusters appears to be reasonably adequate, improvements could be made by patterning the companies' training programs after FCIC's program for its adjusters. All the companies told us that their adjusters had received training in the loss adjustment process. They said the adjusters are provided either in-house classroom and field training, or participate in NCIA-sponsored training. Several companies stated that they use both in-house and NCIA training resources.

The companies said that they hold training sessions several times each year. The training includes both general information about the crop insurance program and specific information about how to adjust claims on specific crops. In addition to the classroom training, we were told that loss adjusters are given on-the-job training under the supervision of

fully qualified loss adjusters. One company also told us that many of its adjusters formerly worked for FCIC; thus, trained adjusters are obtained without incurring additional training costs.

Companies' Reviews of Loss Adjustment Activities Are Inconsistent and Inadequate

Each of the 12 reinsured companies included in our review stated that they had a quality control process for claims adjusted by their employees. The review consists of (1) checking to see that all the necessary forms are present and properly completed, (2) verifying computations, and (3) ensuring that information on the claim is consistent with supporting production and appraisal worksheets.

We were also told by several of the companies that claims may be scrutinized by other pre-payment and post-payment reviews; however, we found no uniformity or consistency in the number and type of reviews made between the companies. For instance,

- One company stated that all claims larger than $25,000 are audited prior to payment; this includes independent verification of acreage and production, and documentation of all adjustment determinations.
- One company said that supervisory reviews are required prior to paying claims of over $20,000.
- Two companies stated that they exercise oversight and control over the work of both their agents and adjusters. However, the controls of one of the companies did not include systematic reviews of the accuracy of claims adjusted by each adjuster.
- One company told us that 5 percent of all claims is audited by a claims supervisor. This involves a total reworking of the claim and includes visits to the field. If the supervisor finds an error on a claim, he then will check that adjuster's future work until he finds that the adjuster can work a claim without error. At that point, the supervisor returns to auditing 5 percent of all claims.
- One company stated that its goal is to audit 10 percent of all claims. However, the goal cannot be met because of the large number of claims processed. In addition, the results of the audit are not documented.

Despite these efforts, as demonstrated by our findings in chapter 2, the oversight and control systems used by the reinsured companies included in our review were inadequate to preclude an error rate of 95 percent, an overpayment rate of 31 percent, and the processing for payment of claims with errors so blatant as to appear intentional.

FCIC's Oversight Over Master Marketer Claims Is More Effective

As we discussed in chapter 3, although we found errors on the claims adjusted by FCIC-supervised contractors, they were not as numerous nor nearly as costly as those we found on the claims adjusted by the reinsured companies. We believe that this is because FCIC exercises direct and more effective oversight and control over the quality of the loss adjustment process for master marketers claims.

FCIC Guidance to Its Adjusters

FCIC is responsible for adjusting losses on all master marketer claims. To do this, they contract with professionally certified loss adjusters. FCIC provides its loss adjusters with specific guidance for adjusting claims. One of the most important FCIC guides is the field operations loss adjustment manual, which includes procedures for (1) determining the applicant's eligibility for crop insurance, (2) preparing revised acreage reports and reports of crop loss or damages, and (3) completing field loss adjustments. The manual also describes the responsibilities and authority of adjusters. Another important tool FCIC provides its loss adjusters is crop handbooks that describe appraisal methods for each type of crop and provide the adjusters instructions for completing FCIC appraisal worksheets. The adjusters use the crop handbook in conjunction with the loss adjustment manual. The manuals and the handbook are similar to the guidance provided by reinsured companies.

FCIC Training for Loss Adjusters

During the period when the claims we reviewed were adjusted, the training that FCIC contract adjusters received was in two phases. Phase one, consisting of 40-80 hours of classroom training, covered general policy provisions and actuarial tables. Upon completion of this phase, the adjusters were tested for certification. A minimum test score of 70 percent was required to complete phase one. Phase two consisted of supervised on-the-job training for 1 year, after which the adjusters were allowed to perform loss adjustments on their own. These "solo" adjustments were subjected to reviews by FCIC quality control supervisors.

Beginning in 1986, FCIC emphasized training for adjusters more than previously. A score of 70 percent or higher on the loss adjustment examination is still required to qualify for certification. Then, for the first year, generally four or five reviews are performed on new adjusters by quality control reviewers.

To become certified, adjusters must adjust four consecutive claims on two different crops (a total of eight) without any major or procedural

errors. A maximum of three minor errors, such as mathematical miscalculations, are allowed. Adjusters can lose their certification for a particular crop if they make two or more major errors on two consecutive claims. To regain their certification, the loss adjustment contractor (LAC) must again go through on-the-job training and accurately work four consecutive claims for that crop.

New adjusters also receive updated training courses as determined necessary by FCIC District Directors. These courses are generally 2 or 3 days in length and focus on problems specific to the FCIC District.

FCIC Oversight of Loss Adjusters

In contrast to reinsured companies, FCIC has a more comprehensive and rigorous program of quality control over the loss adjustment process. Basically, the more errors an adjuster makes, the more rigorous is FCIC's oversight. Among the objectives of the program, according to FCIC's quality control handbook, are to

- determine whether certified loss adjusters are performing their work in accordance with FCIC's policies and procedures;
- determine the need for further training and evaluate the quality of training provided to all field personnel;
- determine whether adjusters can use facts and sound judgment for accuracy and consistency in all determinations, yet maintain satisfactory working relationships with the insured;
- assure uniformity of work among individual adjusters; and
- assure that producers fulfill their responsibilities according to the terms of the insurance agreement.

The quality of work performed by adjusters is scrutinized by FCIC quality control reviewers. Review of an adjusted claim can occur at any of three levels:

- Level one: One out of every 10 claims adjusted by each LAC is reviewed by a quality control reviewer until 3 consecutive claims are found to be acceptable. Then, the adjuster's work is reviewed using level two criteria. However, if two major errors are found, the adjuster is decertified for the particular crop, his/her wages are reduced, and he/she must undergo additional on-the-job training until recertification requirements are met.
- Level two: One of every 20 claims adjusted by each adjuster is reviewed by a quality control reviewer until 3 consecutive claims are found acceptable. If two major errors are found, the loss adjuster's work is

scrutinized more closely, again using level one criteria. If the review discloses no errors, the loss adjuster's work is reviewed using level three criteria.

- Level three: One of every 30 claims adjusted by each loss adjuster is reviewed by a quality control reviewer until the end of the crop year or a major error is discovered. If two major errors are found, closer scrutiny using level two criteria will be required.

If errors are found during the quality control reviews, quality control reviewers are instructed to rework the claims by, when necessary, visiting the field, talking to the insured, and checking production at grain elevators/processors. FCIC requires quality control reviewers to prepare corrected claims for underpayments of more than $25 or overpayments of more than $125.

FCIC Does Not Screen Reinsured Claims for Obvious Errors

In addition to FCIC having more comprehensive and rigorous quality control requirements for master marketer claims than for reinsured company claims, we found one particular control mechanism that FCIC does not use for reinsured company claims that could have prevented millions of dollars in questionable payments. Specifically, we found that for policies sold by master marketers, FCIC screens all claims prior to payment by running a computerized check to identify obvious errors. However, FCIC has chosen not to do this for reinsured company claims. We found that if such a screening process had been used in crop years 1984, 1985, and 1986, FCIC would have questioned at least $17.9 million in potentially erroneous claims.

During our review of reinsured company claims, we found that a soybean grower in Mississippi was paid $68,439, less a deduction for the premium due, for a claim where drought was shown as the cause of loss. However, the farm was operated using a full irrigation farming practice. Contrary to FCIC policy disallowing drought as an uninsurable cause of loss on an irrigated farm, the claim was paid. This situation occurred on eight of our sample claims.

As a result of our experience with the claims in our sample, we decided to determine the frequency that the error may have occurred on other claims for both reinsured companies and master marketers by running a computerized check on all payment files for crop years 1984, 1985, and 1986. Specifically, we programmed the computer to check for all instances where claim payments were made showing drought as the cause of a loss on irrigated farms. We found that this error frequently

occurred on claims adjusted by reinsured companies but did not occur on claims adjusted by FCIC. We also found that FCIC could have easily prevented this from occurring.

FCIC's inadequate screening of reinsured company claims has resulted in millions of dollars of questionable payments. Reinsured companies process and pay claims, and submit the claim data to CHIAA. CHIAA collects the claim information and prepares a computerized data tape that is forwarded to FCIC each month. FCIC uses the tape, which contains the name of the insured, policy number, and the indemnity due, to reimburse the reinsured companies for the claims they paid. Importantly, there is no supporting documentation submitted with the data to aid FCIC in verifying the validity of the claim. As a result, prior to paying reinsured claims, FCIC does not know whether the claim is legitimate or not. Details about the specific elements involved in adjusting the claim, such as the particular farming practice, the farm's risk factor, and the cause of loss, are not submitted by CHIAA to FCIC until the end of the year. Although the year-end tape includes detailed data on all claims, crops, companies, and states, by that time the claims have already been paid. Moreover, we found no evidence that FCIC uses the year-end tapes to determine that the claims were warranted or accurate. We analyzed the year-end tapes for 1984, 1985, and 1986 to determine the extent of FCIC payments on claims where drought was the cause of loss on irrigated farms. We found that for the 3-year period, $17.9 million was paid on 3,846 reinsured claims in this category.

In contrast, for its own master marketer claims, FCIC has a control in place that helps preclude erroneous payments of this type from occurring. All master marketer claims are processed through FCIC's operations office in Kansas City. Prior to payment, these claims are routinely screened by computer to make certain all the claim information is present and in order. For example, the computer ascertains that the crop insured is an eligible crop in that location, the price election and the practice are eligible, and the arithmetic in the calculation of the claim amount is correct. Master marketer claims showing loss by drought are rejected by the computer if drought is shown as the cause of loss on acreage farmed under an irrigated practice. We found no errors involving an uninsurable cause of loss on the master marketer claims we reviewed.

FCIC also could perform computerized audits prior to paying reinsurance claims. To do this, of course, FCIC would have to require the reinsured companies to submit all the supporting claim information needed to FCIC

to use in its screening process. FCIC would then be able to identify, for example, the kind of errors we identified.

FCIC Has Only Recently Begun to Systematically Review the Operations of Reinsured Companies

FCIC reliance on reinsured companies has grown each year since 1981, when FCIC first began using reinsured companies, to 1986, when reinsured companies accounted for about 80 percent of all crop insurance sales. However, FCIC management has only recently responded to the increased use of reinsured companies by establishing an organizational unit to systematically monitor the effectiveness of the loss adjustment activities of reinsured companies. FCIC has taken other administrative actions that should improve its oversight and control. Despite these initial improvements, we believe that much more needs to be done.

FCIC Has Created a Compliance Division to Monitor Reinsured Companies Activities

Until August 1986, when FCIC established a compliance division, FCIC had no systemic way of monitoring the loss adjustment activities of the reinsured companies. Previously, FCIC had only performed sporadic reviews of insurance claims primarily as a result of whistle-blower complaints. The compliance division provides FCIC with the means to systematically review the loss adjustment activities of the reinsured companies.

The compliance division is only now in the process of becoming fully operational. As of October 14, 1987, it has 32 full-time staff and 6 temporary staff members, including support staff. According to FCIC the staff allocation for fiscal year 1988 is 60 positions. The division's handbook indicates its objectives are to

- determine if companies are conforming to the reinsurance agreement and with FCIC-approved policies and procedures;
- determine that premiums, liabilities, and indemnities computed by the reinsured companies and reported to FCIC are accurate;
- ensure that reinsured company loss adjustments conform to FCIC-approved policies and procedures; and
- provide reinsured companies with assistance in handling suspected fraudulent claims.

To date, the compliance division has initiated reviews on its own and has initiated reviews on the basis of whistle-blower complaints from reinsured companies, farmers, other USDA agencies, and other federal agencies. The results of its work, similar to our own, have shown that reinsured companies are not adjusting losses accurately and overpayments are occurring.

It is important to also point out that we could not determine the total number of cases reviewed by the compliance division, the total amount of overpayments identified, or any remedial actions taken. FCIC has not developed a system to track the status of cases or the recovery of overpayments identified by the compliance division, OIG, or us. Further, this situation exists even though FCIC can collect overpayments, plus interest, from the reinsured companies under the Standard Reinsurance Agreement.

FCIC has also taken some actions based on compliance work, but it has been erratic. Overall, we found no consistent pattern of action by FCIC, nor could FCIC provide us any criteria describing when actions are warranted against poorly performing companies or individual claims.

Some cases reviewed by the compliance division have been referred to the Department's Inspector General for criminal investigation. In addition, FCIC suspended one company from writing crop insurance policies because the company lacked oversight and control over its reinsurance activities. In its letter to the reinsured company in December 1986, FCIC stated that the scope of the problems found involving the company's loss adjustment activities, in both quality and quantity, indicate a complete lack of business integrity. Among others, FCIC cited the company for the following violations of FCIC policy and the terms of the reinsurance agreement:

- The company instructed its loss adjusters not to keep proper documentation on claims and to allow losses on claims that normally would be uninsured.
- The company used procedures not approved by FCIC and used forms that did not meet FCIC and industry standards.
- The company paid questionable claims with little or no verification.
- The company failed to validate the insured's interest or share and whether required planting dates were met.
- The company did not properly train its loss adjusters.

Coincidentally, this reinsured company is one of the companies that adjusted claims included in our sample. We found that 37 of our 38 sample claims adjusted by this company were adjusted improperly and were overpaid by more than $1 million.

After a hearing during which the company promised to improve its oversight and quality control, FCIC reinstated the company to continue to write crop insurance policies. However, FCIC informed the company in

February 1987 that unless overpayments were refunded to FCIC by June 1, 1987, the reinsurance agreement would not be renewed for 1988. When the company did not make most of the repayments on June 1, FCIC demanded approximately $506,000 within 15 days or FCIC would offset the amount from payments due the reinsured company plus interest. The company delayed any FCIC action when it claimed to have new and additional information in support of the payments rejected by FCIC. However, by September 30, 1987, the company adjusted its accounting records to reflect that it owed FCIC about $500,000. As of October 14, 1987, FCIC had not renewed the reinsurance agreement with this company.

Compliance division reviews have also identified other significant problems, such as overpayments on specific claims and loss adjustment improprieties by specific companies. However, FCIC has taken no action or has been slow to act. For example, in the case of one reinsured company, the compliance division found overpayments totaling $252,808 on 10 of 11 claims. Yet, FCIC has taken no action to discipline the company or to suspend the adjusters. In addition, FCIC has been slow to recover the overpayments. On another case, the compliance division found that the reinsured company agent was involved in possible forgery and other discrepancies on policies, which could have resulted in up to $895,000 of questionable payments if all policies led to claims. FCIC had the agent debarred but has taken no action to determine how much of the $895,000 was in fact overpaid.

FCIC Has Cited Program Changes to Establish Oversight and Control

In response to our testimony on loss adjustment problems in the crop insurance industry before the House Subcommittee on Conservation, Credit, and Rural Development, on April 29, 1987, the Manager, FCIC, identified several changes to improve the effectiveness and integrity of the program.[1] In addition to establishing the compliance division, these include

- establishing an Assistant Manager for Program Administration, responsible for administering the reinsurance, master marketing, and compliance branches;
- publishing minimum guidelines for the loss adjustment, supervision, and training programs;

[1]See Results of GAO's Review of the Department of Agriculture's Federal Crop Insurance Program (GAO/T-RCED-87-18).

- publishing new requirements to assure that companies determine yields for guarantee purposes according to procedure; and
- taking action against continuously negligent companies by denying renewal of reinsurance agreements to such companies.

If these program changes are implemented as planned, we believe that, in addition to compliance division efforts, they will help to overcome the problems we found during our review.

Agency Comments and Our Evaluation

In commenting on this chapter, FCIC cites our findings and acknowledges that loss adjustment and quality control processes by reinsured companies have not been properly implemented. FCIC also acknowledged that in the past it has not monitored reinsured company compliance with standards. Instead, FCIC depended on the companies' fidelity to FCIC policies and procedures to assure that claims were adjusted correctly. On the basis of our findings, as well as those of others, FCIC has recently taken steps to improve its oversight of reinsured company activities to overcome the kind of problems we identified.

FCIC identified four steps it has taken in this regard. Specifically, FCIC has (1) established the Office of Program Administration which does FCIC's reviews of companies' operations and includes the compliance division, which has become fully operational, (2) published guidelines and recognized standards for reinsured companies to follow in the loss adjustment process and incorporated these into the 1988 Standard Reinsurance Agreement between FCIC and the reinsured companies, (3) published new requirements to assure that reinsured companies determine yields for guarantee purposes according to procedure, and (4) issued guidelines to improve the quality of reinsured company loss adjusters' training and certification programs. In addition, FCIC noted that this year, the private industry loss adjustment trade association (National Crop Insurance Association) has placed increased emphasis on adjuster training and proper claims supervision by the companies.

The steps identified by FCIC, if and when fully implemented, should help improve the quality of the loss adjustments performed by the reinsured companies as well as the effectiveness of the oversight done by FCIC's compliance division. However, two points need to be made about FCIC's comments in this area.

The first point deals with the impact the noted actions will have on actually improving the quality of loss adjustments performed by reinsured companies. The second point deals with the extent of the compliance division's staffing.

The impact of the actions cited by FCIC depends on whether they are implemented effectively. The reinsured companies need to embrace the guidelines and standards provided by FCIC and make sure that they are used by all loss adjusters and supervisors. In addition, FCIC needs to assure that this happens through its compliance division. Further, it should also be noted that each of the actions cited by FCIC has been recognized in the text of the report. (See ch. 4, pp. 38 and 39.)

Regarding compliance division staffing, one important point needs to be made regarding FCIC's statement that its program for conducting "spot check" reviews of the operations of reinsured companies by its compliance division is fully operational. The compliance division was allocated 40 staff positions for fiscal year 1987, and this authorized staffing level increased to 60 staff positions for fiscal year 1988. FCIC acknowledges that it currently has only 31 staff people in the compliance division and that FCIC is now trying to fill the remaining 9 positions. To the extent FCIC's compliance division is not yet fully staffed, effective oversight of reinsured companies is hindered.

Another comment made by FCIC on the matters discussed in this chapter of the report involves the tone of the presentation. Specifically, FCIC commented that the tone of the report implies that FCIC should be giving more oversight attention to reinsured companies' fidelity to procedures rather than to operational processes. Accordingly, FCIC commented that in only one instance in the report—where we discussed its procedures for recovering overpayments—do we allege that procedural requirements are faulty. And, as mentioned previously, FCIC stated that it has made some changes in this area to improve its process for recovering overpayments.

Conceptually, we agree with FCIC's point that oversight activities should focus on monitoring operational processes rather than companies' fidelity to procedures. In this regard, we endorse FCIC's approach in moving more toward that kind of oversight program. However, we do not agree with FCIC's narrow characterization of what our report does and says about the problems we identified. FCIC asserts that we only identify one procedural problem, when, in fact, we identified several. For instance, in

addition to the problems we identified with FCIC's procedures for recovering overpayments, we identified problems with FCIC's procedures for assuring that its process for identifying obvious errors in overpayments was effecti"e. We also observed problems with its procedures for determining when and what actions should be taken against poorly performing companies. Further, regardless of FCIC's or our interpretation of what oversight should or should not be, we found serious problems with the loss adjustment practices of reinsured companies resulting in millions of dollars in overpayments. As a result, we identified several factors which we believe contributed to this problem. FCIC can and should correct the problems whether the correction involves monitoring the processes of reinsured companies or assuring their fidelity to procedures.

Conclusions and Recommendations

Conclusions

During the 1982-86 period, indemnities totaled about $3 billion and premiums $2 billion. The trend in sales has been steadily toward greater use of reinsured companies to the point that about 80 percent of all sales in 1986 were made by reinsured companies. In 1987, the proportion of sales handled by the reinsured companies is expected to increase to about 90 percent.

At the same time that FCIC moved toward the increased use of reinsured companies, it also relinquished many of its own stewardship responsibilities, both fiscal and programmatic, to the reinsured companies. In fact, until 1986 FCIC chose to have minimal oversight and control over the activities of the reinsured companies even though it was paying for most of the losses they generated.

The result of FCIC's lack of oversight and control has led to millions of dollars in overpayments made by reinsured companies, most of which were funded by FCIC. While we looked at a sample of claims for only three crops in five states, the consistency and frequency of the errors we found—along with the lack of a systematic program for oversight and control—leads us to believe that the problems identified are systemic nationwide. From this we can conclude only that FCIC's current approach in dealing with the reinsured companies is not working.

If FCIC is to continue to entrust basic programmatic and fiscal responsibilities to the reinsured companies, it cannot continue to take a "hands off" approach toward the activities of these companies as it has largely done since 1981. This is particularly so since, for the most part, the losses on the crop insurance policies written by the reinsured companies are paid by FCIC, which in turn has been operating at a deficit over the last several years.

In our opinion, the 31-percent overpayment rate that we found on claims adjusted by reinsured companies versus the 1-percent overpayment rate on master marketer claims clearly demonstrates a need for increased FCIC involvement in the activities of reinsured companies. Certainly, the establishment of the FCIC compliance division is a positive development. In addition, the other actions taken and planned by the FCIC Manager should help. However, we believe much more remains to be done. FCIC needs to establish more effective requirements for reinsured companies to use in training their adjusters and for establishing improved quality control practices within the companies. As the results of our work show, the best way to do this would be to pattern these requirements after those now being used by FCIC in its own adjustment

of master marketer claims. Further, FCIC needs to take additional steps to (1) systematically review the loss adjustment programs and practices of the reinsured companies and (2) establish a computerized audit or screening to acquire control over the validity and accuracy of the claims data provided to it by the reinsured companies.

Further, to deal with the overpayments that have been identified during our review and that may be identified by the compliance division or others at some future time, we believe FCIC needs to establish a systematic method to ensure that overpayments identified are repaid, with interest where appropriate. Along these same lines, FCIC needs to establish a process for determining when and what administrative actions should be taken against reinsured companies found to be performing poorly. Finally, regarding the $17.9 million in claims paid on irrigated farms for a drought-inflicted loss, FCIC should make a detailed analysis of the claims to determine how much of these moneys should be recovered.

Recommendations to the Secretary of Agriculture

In order to improve the quality of the loss adjustment practices of reinsured companies, we recommend that the Secretary of Agriculture require the Manager of FCIC to develop and publish the guidelines now in process for improving the quality of the loss adjustment activities of reinsured companies and the associated training programs for their loss adjusters. In doing this, the Manager of FCIC should require that reinsured companies pattern their loss adjustment programs—including loss adjuster training and supervisory quality control reviews—after the more comprehensive and rigorous programs now used by FCIC for claims it adjusts on policies sold by master marketers.

In order for FCIC to acquire the needed financial and programmatic oversight and control over the loss adjustment activities of reinsured companies, we recommend that the Secretary of Agriculture require the Manager of FCIC to

- Implement a comprehensive and systematic monitoring and evaluation program by FCIC's compliance division to ensure that the uniform standards set forth by FCIC are being followed. FCIC's evaluation of the effectiveness of company activities should include readjusting a sample of claims to determine whether loss adjustments are being performed accurately.
- Require reinsured companies to submit documentation to FCIC in support of each payment request at the time the request for payment is made to

help ensure that payments by FCIC are accurate and justified. FCIC should then verify the information submitted using a statistical sampling approach. This process should be used until FCIC fully implements the kind of control system referred to in the preceding recommendation. Once FCIC implements a comprehensive and systematic monitoring and evaluation system, there would be no need for FCIC to continue receiving the supporting documentation on all claims.

- Establish internal controls, such as a computerized audit or screening, over reinsured claims prior to payment to ensure that the claims do not contain obvious errors. These controls would be similar to the controls FCIC has now on master marketer claims.
- Establish guidelines for determining when and what administrative actions to take against reinsured companies that do not follow FCIC's standards or that continue to adjust claims improperly.
- Establish a systematic process for determining whether identified overpaid claims have been repaid to FCIC, with interest where appropriate.
- Require repayment by reinsured companies of the $3 million in overpaid claims we found, in accordance with the terms of the reinsurance agreements.
- Determine how much of the $17.9 million in payments where drought is shown as a cause of loss on irrigated farms is erroneous and pursue collection of that amount.

Agency Comments and Our Evaluation

In commenting on the conclusions in this chapter of the report, FCIC agreed with our conclusion that the problems we identified in this report are systemic. However, FCIC also stated that the master marketer loss adjustment activities have contributed to its deficit operations as well as the loss adjustment activities of reinsured insureds.

While FCIC's comment is correct, our work focused on the reinsured companies because at the time of our review the reinsured companies did 80 percent of all crop insurance business and were expected to do 90 percent of this work in 1987. This, combined with the fact that we found a 31-percent overpayment rate on claims adjusted by reinsured companies and only a 1-percent overpayment rate on claims adjusted by FCIC, led us to conclude that the reinsured companies, not the master marketers, were a greater factor in contributing to FCIC deficits. We still believe this conclusion is merited.

Further, FCIC disagreed with our conclusion regarding the need to develop a systematic approach for recovering identified overpayments.

Specifically, FCIC commented that it does have a systematic method of recovering overpayments.

While FCIC disagrees with our conclusion regarding the need to develop a systematic approach for recovering overpayments, FCIC's comments do not seem to support its disagreement. Specifically, on page 8 of its comments (see p. 62, app. V) FCIC states that procedures are now being formalized for the systematic tracking and collection of overpayments. Also, FCIC states that it is now developing a tracking system to provide it, among other things, with information on the status of overpayments, recoveries, and follow-up actions. Further, during our review we discussed this matter with the heads of the Office of Program Administration and the compliance division. These officials are the cognizant individuals for this aspect of FCIC's operation. Neither official could provide us with the status of FCIC's efforts to recover identified overpayments.

Regarding our proposed recommendation that reinsured companies be required to submit documentation in support of each payment request to FCIC, FCIC commented that since it has already implemented a systematic and comprehensive monitoring and evaluation system for reinsured company compliance, there is no need to require that individual claims files be submitted for review. Further, FCIC stated that such a requirement would be prohibitively expensive since in 1986 there were over 84,000 loss claims. According to FCIC, reviewing documentation in support of each of these claims would increase personnel costs by an estimated $2 million and would also result in logistical and storage cost problems.

In the last several months FCIC has made significant progress in establishing and implementing a more comprehensive and systematic monitoring and evaluation system for overseeing the activities of reinsured companies. During this time, FCIC has begun to focus its compliance division's efforts more on reviews of company operations and loss adjustment. FCIC expects that it will complete these reviews for all reinsured companies during the fall of 1987.

While FCIC has made progress in establishing and implementing better oversight, we have not changed our proposed recommendations because FCIC has not yet implemented the kind of systematic and comprehensive monitoring system envisioned by our recommendation. According to a program official, the kind of monitoring work FCIC has done to date and is expected to complete in the fall of 1987 does not focus on the loss

adjustment process. The approach taken by FCIC has been to look at different aspects of company operations for each respective review. In light of the findings in our report, as well as others, we believe the FCIC needs to focus its work on getting the loss adjustment process under control. To do this, FCIC needs to specifically examine the loss adjustment process for each company. Until this is done and FCIC satisfies itself that the loss adjustment by reinsured companies has improved and is consistent with FCIC requirements, FCIC should require the reinsured companies to submit supporting documentation with each claim so that FCIC could verify their validity and accuracy.

In addition, regarding FCIC's point that such an approach would be too expensive and would cause logistical and storage cost problems, we disagree. As our recommendation states, there is no need for FCIC to review all of the more than 84,000 claims submitted. FCIC can verify the accuracy and validity of the claims using a statistical sampling approach. This would cut down significantly on the personnel costs. And, while FCIC is correct in that the approach we are recommending would probably prompt some logistical and storage problems, the problems would be only temporary. Moreover, it seems to us that this approach would be far cheaper than the current approach—where 95 percent of the claims we reviewed had errors resulting in an overpayment rate of 31 percent. In the 134 reinsurance claims we reviewed for this report, we identified overpayments of over $3 million. In light of the monetary significance of our findings, we believe that the temporary logistical and storage problems FCIC would experience would be more than offset by the increased savings that would accrue from its more effective oversight. As a result, we see no need to revise our recommendation o this; we believe it still has merit.

FCIC also commented on our recommendation c the need to establish internal controls to ensure that claims do not ontain obvious errors. Specifically, FCIC commented that we seem tc assume that FCIC has done nothing in this area, when FCIC insists it has.

As our report demonstrates, FCIC does not have computerized claims checks for reinsured company claims as it has for master marketer claims. This was demonstrated by the fact that we found $17.9 million in claims paid for drought on irrigated land—a condition that is prohibited by FCIC policy. This would not have occurred if FCIC had an internal control check, such as a computerized screening process, that would have caught the errors before claims were paid. In contrast, we found that such checks were in place for master marketer claims. Our point in

making the recommendation is to encourage FCIC to perform checks that would preclude obvious payment errors prior to payment. We did not review all of the edit or screening checks referred to by FCIC in its comments. Nonetheless, it is clear they are not sufficient; otherwise, the $17.9 million would not have been paid before the claims were fully evaluated.

Regarding our final recommendations—dealing with administrative actions against poorly performing companies, developing a tracking system for recovering claims overpayments, requiring the repayment of overpaid claims by reinsured companies, and determining whether the $17.9 million in payments made for drought on irrigated land is legitimate—FCIC commented that it either plans to act or is in the process of acting on each recommendation.

Additional Examples of Reinsured Claims Where Program Eligibility Was Not Met

Example C. A soybean grower in Oklahoma insured two farms in separate counties. Because the farms were in different counties, a separate policy for each farm was required by FCIC. Claims on both policies showed no harvested production and appraised total potential production of only 319.5 bushels. As a result, the insured was paid $127,619.

We found, however, that the insured had no insurable interest in either property. The producer, who was also the reinsured company's agent, told us that he operated the two properties but that he had insured the properties in his father's name so that, in the event of an indemnity payment on either or both policies, he could avoid paying two court-ordered judgments against him. However, FCIC policy is clear on the issue of insurable interest. The insured must have an insurable interest in the crops, or no insurance coverage can be provided. Since the policy was in the name of the producer's father, who had no insurable interest in the crops, the entire indemnity of $127,619 was an overpayment.

The reinsured company manager in this case disagreed that the indemnity was an overpayment and stated that the producer paid the rent on these farms and claimed the indemnity on his federal tax return. The manager also provided us with copies of cancelled checks for the rent paid by the producer to a bank and certain sections of the producer's 1985 tax return. We found, however, that the producer's father neither owned nor rented the insured acreage and thus had no insurable interest in the crops. The claim payment is in violation of FCIC policy.

Example D. A soybean grower in Mississippi was ineligible for insurance because the crop was not planted by the required date. In conjunction with the FCIC loss adjustment experts, we determined that the insured's land was not planted by the required date. In fact, the majority of the land had not even been tilled. Apparently, contrary to FCIC procedures, the agent did not ensure that the producer planted the crop by the required plant date. As a result, overpayments totaling $47,739 occurred on the policies of the grower and the landowner, both of whom had insured their shares of the crop.

We learned this because the county ASCS officer told us that he suspected that the farmer did not plant the soybeans by FCIC's required plant date. We then had a certified agronomist review infrared slides taken 3 weeks after the required date. The manager of the reinsured company disagreed with our findings and stated that ASCS procedure states that aerial compliance 35mm slides cannot be used as physical evidence of a crop.

We believe that our findings are valid. First, ASCS procedures sometimes differ from those of FCIC. Second, the ASCS procedure cited by the manager pertains to accepting a late-filed acreage report and has no applicability to the last plant date under the FCIC program. The infrared slides we had analyzed proved that no crop had been planted for up to 3 weeks after FCIC's required planting date.

Additional Examples of Reinsured Claims Where Production Guarantee Was Wrong

Example C. A Mississippi soybean grower insured 926.8 acres using an irrigated farming practice that provided the highest per-acre guarantee and resulted in a total production guarantee of 19,622.4 bushels. We found, however, that 223.5 acres were farmed without irrigation, making the guarantee for those acres overstated. Further, we found that none of the acres, irrigated or nonirrigated, qualified for the highest per-acre guarantee because of evidence that the soil sample verifications required to qualify for the highest guarantee were not in the case file. (In 1984, FCIC required soil sample analyses to prove that the soil's pH factor was high enough to warrant the highest guarantee). In conjunction with the FCIC loss adjustment experts, we determined that the correct production guarantee was only 6,778 bushels after reducing all acres to the appropriate farming practice guarantee. Because the amount of actual production exceeded 14,000 bushels, no claim was warranted. The amount of overpayment in this case was $44,616. This figure represents the original indemnity of $34,525, plus the premium due of $10,091.

In response to our findings on this claim, the manager of the reinsured company stated that on a visit to the insured's farm in February 1987, it was observed that the farm was irrigated; therefore, the irrigated practice used by the adjuster was correct. However, we do not believe that whether or not the farm is irrigated in 1987 is relevant because the claim was based on crop year 1984. Further, our determination that a nonirrigated practice should have been used to determine the guarantee on certain acres is based on ASCS acreage reports certified by the insured in 1984 showing that the acres in question were not irrigated.

As to the soil tests issue, the manager stated that the required tests were made and provided us with copies of soil tests conducted in October 1983 by a laboratory in Terre Haute, Indiana. This, however, conflicted with a statement from the insured who said that the soil sample was made by an extension service in Mississippi in 1982. Because of the conflicting statements, we did not have acceptable evidence that the required soil tests were made.

Example D. In Oklahoma, a soybean grower received a loss payment of $71,876 in 1985. We found, however, that the claim was overpaid by $16,450 because (1) the risk factor assigned to about 41 percent of the acres farmed was incorrect, (2) the total number of acres insured was incorrect, and (3) all production from the farm was not counted by the loss adjuster. For simplicity, we are limiting our discussion to the error involving risk determination.

The producer's claim was based on 741 acres, all assigned a risk factor 3, which meant that FCIC's production guarantee was 18 bushels per acre. However, we found that only 708.6 acres were farmed, and only 418.8 of those acres should have been assigned a risk factor of 3. Of the remaining 289.8 acres that were farmed, 60 should have been assigned a risk factor of 2, with a production guarantee of 15.5 bushels per acre; 164.8 acres should have been assigned a risk factor of 1, with a production guarantee of 13.5 bushels per acre; and 65 acres were unclassified and therefore uninsurable. Thus, on the acres actually farmed, the producer's guarantee should have been 2,644.8 bushels less than was actually guaranteed. The 2,644.8 bushels multiplied by the $6.50 per bushel price option resulted in an overpayment of $17,191.

The manager of the reinsured company in this case agreed with our finding that the risk area assignment by the adjuster was not correct.

Additional Example of Reinsured Claims Where Actual Production Was Wrong

Example B. A soybean grower in Mississippi received an indemnity from FCIC based on a production guarantee of 9,199 bushels and actual production of 5,458 bushels—a shortfall of 3,741 bushels. However, we determined that the insured had harvested additional bushels of soybeans that the adjuster had not included in his actual production determination and that he had farmed additional acres. We found documentation at the ASCS county office that the insured had received a loan from ASCS using his total harvested production as collateral. The additional bushels increased the total amount of actual production to 24,426 bushels, and the corrected production guarantee increased to 24,120 bushels. Because the amount of actual production exceeded the amount of production guarantee, no claim was warranted. The amount due back to FCIC, including the insurance premium, is $39,029.

We are uncertain as to why most of the production from the insured's farm was not counted by the adjuster. The Claims Supervisor for the reinsured company in this case agreed with our determination of the overpayment.

Results of Review of Claims Adjusted by FCIC, by State and Crop

State and crop	Total claims		Claims overpaid		Claims underpaid	
	Number	Amount	Number	Amount	Number	Amount
California—grapes and raisins	6	$34,672	0	$0	2	$5,264
Louisiana—soybeans	9	217,768	7	5,603	1	410
Mississippi—soybeans	8	392,298	4	4,161	1	213
Montana—wheat	8	1,023,904	4	12,838	2	374
Oklahoma—soybeans	6	57,217	2	3,015	0	
Total	**37**	**$1,725,859**	**17**	**$25,617**	**6**	**$6,261**

Source: Our analysis of claims reviewed on policies sold by master marketers.

Comments From the Federal Crop Insurance Corporation

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of Agriculture | Federal Crop Insurance Corporation | Office of the Manager | Washington, D.C. 20250

To J. Dexter Peach
Assistant Comptroller General
Resources, Community, and Economic Development Division

From E. Ray Fosse, Manager
Federal Crop Insurance Corporation

Subject GAO Draft Report, GAO/RCED-87-179

Attached are the comments of the Federal Crop Insurance Corporation (FCIC) and the Department of Agriculture on the subject report.

FCIC wishes to note that the imperative to follow-up on the identification and recovery of overpayments requires specific case information which was indicated would be furnished, for use in this response, during the discussion with GAO transmitting the draft report for comment on July 28, 1987.

On the basis of our earlier notice and review, and the general information available in the report, we completed the review and served notice on one of the two companies responsible for a significant majority of the alleged overpayments. As soon as the case summary information is received on the other company, and the remaining audits, we are prepared to expedite the review and recovery process for other items as appropriate.

Attachment

Federal Crop Insurance Corporation is an agency of the United States Department of Agriculture

Comments of the Federal Crop Insurance Corporation
on the Draft Report GAO/RCED-87-179, Dated July 28, 1987

GENERAL COMMENTS

As the Federal Crop Insurance Corporation (FCIC) noted in its oral testimony on the preliminary report of the General Accounting Office (GAO) findings on the subject audit, more attention to oversight in general, procedural and programmatic, has been a major thrust of FCIC management for nearly two years. We are now beginning to see progress in tighter management at all program levels, particularly in relation to financial reporting and control.

With direction from the Congress, expansion of the program and the availability of insurance to producers were the major goals of the early 1980s. As many familiar with this period recall, it was not without significant problems for FCIC management that these objectives were achieved, particularly with regard to our own claims and service operations. Program changes, fine tuning, experimentation, and just plain learning kept all of us off center during these years.

While FCIC management concedes many of the findings of the GAO in its review of individual cases, we have a serious concern over two major implications contained in the Summary and underlying the tone of the report.

See comment 1.

The first is that the function of oversight involves participation in, or replication of, processes rather than monitoring for fidelity to procedure. In only one instance, that of recovery of discovered overpayments, does the report allege that procedural requirements are faulty. We have taken steps, with the 1988 Reinsurance Agreement and various new procedures, to address that issue.

See comment 2.

The second major implication about which we are concerned is the repeated inference that the errors discovered were so egregious as to suggest willful attempts to defraud.

While fraud is a major concern of all insurance companies, and of federal programs, we believe that the predicates to allegations of fraud in the cases cited are not supported. That individual agents, producers, loss adjusters, and company management would engage in such programmatically and geographically disparate fraud is unlikely. We did discover, prior to the GAO findings, a pattern of procedural neglect which characterized the operations of one company which led to a temporary suspension and continues to require specific monitoring. But it should be noted that, under current agreements, only the insured benefits from a favorable loss adjustment decision. With lax claims oversight, the company not only loses premium (income) to pay indemnities (losses), it encourages laxity on the part of loss adjusters which ultimately will impact on non-subsidized operating funds of the companies. As we noted in our earlier testimony, the lack of attention to internal oversight on the part of the companies is not evidence of an intent to defraud on the part of any claimant, adjuster, or company.

COMMENTS ON STUDY PARAMETERS

The GAO notes that the 92% rate of error discovered during the audit leads to the conclusion that those errors are systemic. Clearly the discovery of an error rate of 62% within the FCIC system lends credibility to such a conclusion.

See comment 3.

However, we might note that the comparison of the 31% overpayment rate for reinsured business with a 1% rate for FCIC should be cautiously used. A more indicative comparison of payment levels would require audits of claims of comparable value.

See comment 4.

With regard to these two points we can make a crucial comment on the contents of the study. An analysis of the individual case reviews made known to FCIC indicates that nearly 75% of the claims audited, comprising about 65% of the errors and 75% of the overpayments detected, were the responsibility of two companies. One of those companies, responsible for an estimated 30% of the claims' errors, is the one identified in our earlier comments as the subject of disciplinary action by FCIC; the other, while not the subject of action prior to the GAO report, will certainly command special review as a result of these findings when case information is received from GAO.

See comment 5.

Informal information on audit results on the remaining companies' operations reveal that the dollar rate of payment error generally did not exceed 10% of indemnities paid. In two cases, the size of a single claim inflated the level of alleged overpayment and, in both of those cases, the company is strongly disputing the GAO audit finding. While errors are regrettable, we believe that these numbers, even without reconciliation of GAO-company disputes, indicate a much greater fidelity to fiscal accuracy in the claims process than the GAO report implies.

Crop insurance is a complex program, and FCIC will continue to refine its oversight of reinsured company compliance through written crop insurance procedure and standard insurance industry claims practices. We have embarked on that refinement, and have made significant progress in meeting our goals. While some measure of the effect should be demonstrated in 1986 crop year activity, it is likely that the full effect of the actions we have taken will not be reflected until 1987 crop year operations.

FINDINGS ON REINSURED COMPANY OPERATIONS

See comment 6.

In oral testimony we noted that it will be necessary for our compliance staff to review each of the claims audited by the GAO to reconcile the differences between GAO and individual company analyses. This activity, and the recovery of overpayments, will proceed as rapidly as GAO provides sufficient case information on the claims audited.

In describing the process of insurance sales and service we believe the GAO report makes a fundamental error which has a significant effect on the perception of weakness in the loss adjustment process. In the section "FCIC's Loss Adjustment Process" it is stated that "the loss adjuster has prime responsibility for determining the production guarantee, actual production, and the indemnity due on each claim."

The primary responsibility for the determination of the production guarantee lies with the selling agent and the underwriting office. As the agent must assure that the policy provisions and acreage insured are appropriate to the individual situation, so must assurance be provided that the past production statistics are accurate and provable, that the appropriate practice is reflected, and that the location and classification of the land in question is accurate. This information is provided in the application and the acreage report and is the basis on which the underwriting office (a company's central office or the FCIC regional office) establishes premium and coverage.

While placing responsibility for these actions with one element of the insurance delivery system rather than the other may seem marginally important, it is crucial in establishing a correct sense of accountability and the parameters within which a loss adjuster is normally expected to work. The selling agent has the responsibilities enumerated above precisely because this is the point of immediate contact with the insured--the source of most of the information and the person who will have to pay the bill for the coverage.

It is incumbent upon the loss adjuster to verify the information. Only when an inconsistency or some irregularity is discovered is it necessary to repeat the work the sales agent has already done. Some program changes, such as APH, have reduced the elements of information required for both agent and adjuster. The general review of the factors involved in establishing the insurance guarantee, the source of more than half of the errors uncovered in the audit, should only reach the degree of verification outlined in the report when, as noted, a reason to question the policy coverage develops.

As we note, this fact does not shift the need for oversight away from the company. It does focus on the need for improving sales training and oversight, in both systems, in addition to enhancing claims review. It also makes clearer that the loss adjuster, whose task is complex enough with the establishment of actual yields, the verification of a covered cause of loss, and the calculation of indemnities which are frequently complicated with quality adjustments, should be able to rely on the integrity of the processes which have gone before.

To illustrate further some of the difficulties in properly addressing audit questions, GAO assumes, in a case listed under "Determination of Production Guarantee" (Example B) which involves irrigated versus non-irrigated practice, that the entire claim is invalid and the entire indemnity constitutes an overpayment. An error apparently occurred here, but GAO's assumption may misstate the audit conclusion. The FCIC Field Operations Office Loss Adjustment Manual, issued in 1984, which covers procedural policy for loss adjustment purposes and was furnished to the Reinsured Companies, directs that a claim with this type problem be adjusted differently than GAO proposes. The case cited does not state that the producer had an irrigation system in place and did not use it, but that it was misreported as irrigated when it was non-irrigated. Assuming the latter is correct, FCIC procedure instructs the adjuster to factor down the production guarantee by dividing the lower irrigated premium-per-acre by the non-irrigated premium-per-acre, then multiply the result times the per-acre guarantee. Specifically, FCIC reduces the production guarantee and adjusts the claim and the premium as non-irrigated. It does not deny the entire claim. This case illustrates the confusion which the claims process can engender, since in other reviews the GAO auditors apparently followed correct FCIC procedure in their analyses.

The complexity and judgement factors associated with the crop insurance contract lend themselves to disputes and, therefore, auditable error. The individual cases cited in the report, and the claims used as the basis for the report, will be reviewed when they are received. In some of the cases, it is likely that there will continue to be differences of opinion among the GAO, FCIC, and the company. In others, clearly there is error. In yet others, there will be found error, but of a nature which only an audit of the depth conducted by the GAO would discover.

Elsewhere in these comments we address, specifically, the recommendations and suggestions of the auditors. The errors, as we noted, represent a failure to meet our claims standards. The FCIC has implemented mechanisms to require greater fidelity to general operational standards of efficiency, effectiveness, and integrity. We shall hold our delivery partners to those standards.

LOSS ADJUSTMENT ERRORS ON MASTER MARKETER CLAIMS--
FREQUENT BUT NOT VERY COSTLY

The report analyzes 37 claims recorded for Master Marketer policies and adjusted by Federal Crop Insurance. The analysis found that 23 of the claims reviewed (62%) were not properly adjusted accounting for a total overpayment/ underpayment amount of $31,878(1.87%) out of a properly paid $1,706,503.

The report considered the errors experienced in this range to be within an acceptable margin of error. It is gratifying that the indemnity error amount in the review sample is less than 2%. A payment error rate of less than 2%, however, is so low that it may represent the tail of the actual error distribution curve, based on size of claim, rather than the mode or mean.

It is worth noting that, with one of the tightest spans of supervisory oversight, and the equivalent of roughly 1 of every 3 claims filed reviewed a second time, an error rate of 62% dramatically demonstrates the complexity of the crop insurance product and the claims process.

As noted earlier, we take little solace in the overpayment rate which was discovered since we feel that it is likely not representative of the results which an audit of high value claims chosen by the same GAO criteria would reveal. There are three avenues of recourse available to insureds and/or applicants for insurance to resolve disputes arising from crop insurance contracts administered by FCIC under the Corporation's direct writing system. Crop insurance claimants who used these appeals opportunities, applying to the FCIC insurance program, amounted to 247 at the Kansas City level for 1986. Of that number, even with the extensive oversight outlined above, 27% prevailed. Following rejection at the first level of appeal, 99 claimants pursued their case to the Washington level, and prevailed in 25% of cases brought. Thus fully 37% of appeals on FCIC claims were found meritorious by a review process analogous to the GAO audit. FCIC is also involved in litigation at a rate which private companies could scarcely afford to sustain. During the period October 1, 1986, to May 26, 1987, FCIC estimated a total liability in 62 filed suits of $116,600,057. There were 36 suits pending for $98,705,523. These suits are primarily over disputed claims with the most frequent points of contention being: 1) policy interpretation; 2) uninsured cause of loss;

See comment 7.

See comment 8.

3) disputed production; 4) disputed actuarial determinations. These issues are precisely those at the basis of the audit findings. During oral testimony, we noted the potential the threat of litigation has for coercing disputed claims settlements.

In January of 1987, a study team was organized to identify problems in field operations and determine more effective and efficient methods of operation. The study concluded that quality control should not be a part-time function working outside the supervisory chain of accountability, and that the system should be simplified and administrative reponsibility clarified.

To this end a new field structure was created. The new position of Area Claims Specialist will focus around full-time, professional level supervision, training and quality assurance of the loss adjustment contractor force from an Area Claims Office. In addition, two other positions were created in the redesigned Field Service Office at the regional level: the Claims Examiner position and the Staff Assistant.

The Claims Examiner will review for approval of payment all claims prior to processing (where additional computer checks will be made). This position, under the administrative control of a Field Service Office Director, will be responsible for overall coordination of training and quality assurance in the region. The Staff Assistant will perform administrative and program analysis of loss adjustment operations within the region, to determine effectiveness, efficiency and trends.

We believe this approach will provide more responsive administrative control and integrate efforts towards a more effective accomplishment of accurate, economical, and timely loss adjustment. As GAO notes, attention to procedure and fidelity to a system of internal controls is at the foundation of a more accurate and efficient experience for both delivery systems.

FCIC DOES NOT HAVE ADEQAUTE OVERSIGHT
AND CONTROL OVER REINSURED COMPANIES

In August 1986, FCIC's newly created Office of Program Administration became operational with responsibility for administering the Compliance, Reinsurance Contract and Marketing Contract Divisions. This function has been given top priority and emphasis by FCIC in fulfilling it's obligations under the Federal Crop Insurance Act, as amended, to assure that private contractors are in compliance with the terms and conditions set forth in the applicable agreements.

REINSURED COMPANIES' OVERSIGHT AND CONTROL OF
THE LOSS ADJUSTMENT PROCESS ARE INEFFECTIVE

FCIC has always strongly encouraged reinsured companies to adhere to standard supervisory and internal control procedures. While recent reviews suggest some companies did not perform this function to FCIC's satisfaction or desire, steps have been taken to assure this will be accomplished for the 1987 and succeeding crop years.

In this connection, it may be appropriate to observe that, absent the type of review undertaken by GAO, the FCIC depends precisely on the fidelity to policy and procedure of both of its delivery systems for the integrity of the program. In the instance of each of the reinsured companies, of course, we rely on the integrity of its internal control and review system. We have taken steps to assure greater administrative attention to that requirement on the part of the companies and we intend to audit for fidelity to that requirement. (Attached at Appendix I is a representative company's standards manual). The repeated references to "FCIC procedure" are misleading in that ALL procedure is either established by, or approved by, FCIC. It is in the area of assuring fidelity to procedure that we must make progress. This is why FCIC conducts its spot check review program and we are pleased that, for the 1987 season, we are fully operational.

FCIC established guidelines and recognized standards (See Appendix II) for reinsured companies to follow and incorporated this requirement into the 1988 Plan of Operations, a part of the Reinsurance Agreement.

In February 1987, FCIC issued guidelines and standards (See Appendix III) for reinsured companies to utilize in their role as third party verifiers for the Actual Production History program. This reinsured company verification function is presently under review by FCIC personnel to assure these standards are adhered to and utilized.

FCIC issued in February 1987 recognized and approved guidelines for loss adjuster training and certification programs (See Appendix IV) to be implemented by reinsured companies. FCIC has and continues to monitor and review company training provided to loss adjusters. Increased emphasis, by the private industry loss adjustment trade association (National Crop Insurance Association), was placed on adjuster training and proper claims supervision at meetings with the member companies this year.

FCIC DOES NOT SCREEN REINSURED CLAIMS FOR OBVIOUS ERRORS

See comment 9.

Edit checks are performed by reinsured companies prior to claim processing and before accounting reports and premium transactions are generated to FCIC for reimbursement. In addition to internal manual and computerized checks, reinsured company loss claims are subject to FCIC-approved computer edit checks by the statistical trade association, Crop Hail Insurance Actuarial Association (CHIAA) prior to certification for payment. Currently several additional edits are being implemented. Claims not passing edit checks are returned to reinsured companies for correction and resubmission. The edit checks are very similiar to those utilized by FCIC and have been subject to Office of Inspector General audit review and validation.

See comment 10.

We are concerned that the GAO places repeated emphasis on the payment of certain drought losses. As we stated in our earlier testimony, an error occurred in the updating of our edit codes which permitted recording of a drought cause of loss on irrigated land even on FCIC business. We also noted that we would attempt to review the specific instances for reinsured business when given the material on which GAO based its observations, but that a preliminary review indicated erroneous cause of loss coding rather than erroneous payments. This does not, of course, relieve the FCIC or the

companies of the burden of statistical error; it does, however, question the implication of some $18 million in wrongfully paid claims.

See comment 11.

FCIC management has begun to evaluate each item of the 3,846 claims involving drought on irrigated practice to determine the appropriateness of the $17.9 million in reinsured company payments and $1.2 million in FCIC indemnities. Preliminary analyses of the data by FCIC indicates drought was not always listed as the primary cause of loss and that irrigated practices frequently had additional causes of loss reported. Some of the additional causes listed were excess heat, failed irrigation, hot wind, disease, insects and other causes that could be associated with drought conditions. In the absence of strictly defined cause of loss codes, the adjuster is left to use his/her judgement and often attempts to explain a loss by the use of multiple codes--a conscientious effort to complete a claim.

Management will continue its review both by audit of randomly selected claims and by further examination of the data base. Edits, in the meantime, have been added to both CHIAA and FCIC processing routines to prevent improper recording of drought cause of loss on irrigated practice. FCIC will, additionally, examine the desirability of defining cause of loss fields more narrowly and explicitly and making such codes available to companies and adjusters. FCIC management questions that sufficient appropriate data were used to make the blanket assumptions of overpayments of the extent that the GAO claims.

FCIC HAS ONLY RECENTLY BEGUN TO SYSTEMATICALLY REVIEW THE OPERATIONS OF REINSURED COMPANIES

Active oversight by FCIC of individual reinsured company operations was not a major thrust of corporate management in the early years of the multiple peril crop insurance program. Mechanisms within the reinsured companies were initially relied upon for procedural controls, since for many years these companies had been engaged in general crop insurance prior to their participation in the multiple-peril program.

See comment 12.

Recognizing the need for a more formalized approach, FCIC forwarded to the Department a reorganization plan requesting approval of a compliance program in the fall of 1985. We received approval for the establishment of the Compliance Division in November 1985. Initial staffing began for this function in April 1986 with the majority of field review personnel staffed in August 1986. The Division was allocated a ceiling of 40 staff positions for fiscal year 1987. This allocation has been increased to 60 for the 1988 fiscal year. The Division currently has a staffing level of 31 specialists and clerical personnel with open recruiting announcements to fill remaining vacancies. The Division utilizes two branch offices, located in Washington, D.C., and Kansas City, Missouri, to perform the daily review activities. There are current plans to add another branch office to assure uniformity and compliance of all contracting parties and to facilitate an efficient review program for both delivery systems.

See comment 13.

Training and procedural development were initiated immediately upon organization. Compliance Handbook procedures were recently approved by FCIC management for the systematic review of reinsured companies. These procedures

were coordinated and derived from other review and audit programs such as other USDA agency compliance programs, Office of Inspector General, National Association of Insurance Commissioners and the National Flood Insurance Program. Procedures are currently being formalized by the Office of Program Administration for systematic tracking and collection of overpayments identified by compliance and other review/audit programs.

See Comment 13.

While initial review efforts were directed at handling complaints and whistleblower cases, a concentrated and successful effort has been made to incorporate a systematic review program on all reinsured companies. During late 1986 and early 1987, the Compliance Division has been performing systematic reviews on reinsured companies. It is projected that by October 1987, all reinsured companies will have been reviewed, particularly in the area of company operations and loss adjustment activities. To date the Compliance Division has completed review of over 30 reinsured companies, entailing 59 case reviews, involving an estimated 940 policies. These reviews have occurred in twenty-five states and involved twenty different crops.

See comment 13.

With a team of its experienced field underwriting staff, FCIC is currently reviewing all reinsured companies in their role as third party verifiers for the Actual Production History program and anticipates completion by mid-September, 1987. In 1986 FCIC performed this function with review results indicating an approximate error rate of 1%.

In 1986 FCIC consolidated and moved to Washington, D.C. the Program Administration function, which is responsible for contract administration for both delivery systems and oversight responsibilities. This office has coordinated and issued guidelines and standards for reinsured company performance under the Standard Reinsurance Agreement.

See comment 13.

We note the incorporation into the 1988 Standard Reinsurance Agreement several provisions placing greater oversight and control requirements on the reinsured business. These include the authority for FCIC to assume and perform the loss adjustment activities of a reinsured company, if a company has demonstrated continued performance and practices not in accordance to provisions of the Reinsurance Agreement; more precisely defined regulations to prohibit conflict of interest situations between loss adjusters, agents and producers; written regulations to recover overpayments to companies by FCIC and required wording on all policies informing producers their insurance policy is reinsured by the Federal Crop Insurance Corporation and as such all terms of the policy and rights and responsibilities of the parties are specifically subject to the Federal Crop Insurance Act, as amended. Companies have been required to provide additional documentation and information on procedural integrity with their 1988 Plans of Operations prior to reinsurance agreement approval.

See comment 13.

The Compliance Division is nearing completion of a data base, containing all case reviews and related findings, both statistical and monetary. The Assistant Manager for Program Administration is currently developing and implementing a data base tracking system to monitor case review reports of reinsured companies, the status of required recoveries along with requested actions, and follow up with the companies. This data base will be used to monitor and disseminate all compliance reviews, OIG and GAO audits.

See comment 13.

FCIC has recently requested several OIG investigations resulting from oversight activities. Several loss adjustment bulletins have been issued advising of potential problem areas or required changes in loss adjustment practices as a result of review and oversight activity (See Appendix V).

CONCLUSIONS AND RECOMMENDATIONS

In general response to the implications of several conclusions which are drawn we believe it should be noted that the deficit operation of the last several years is not just on the business written by the reinsured companies. As we presented in testimony, the loss ratios on FCIC policies are no better and sometimes worse than loss ratios on policies reinsured. In this regard, we can reiterate our agreement with the GAO findings that the problems we face are systemic in that they characterize the difficulties faced in offering an effective and responsive crop insurance program.

See comment 14.

We have stated at several points in this response that additional requirements have been placed upon the reinsured companies in the areas of adjuster training and supervision and quality control functions throughout the sales and service cycle. We note also that the companies have a trade association (NCIA) whose principal purpose is the provision of crop insurance adjustment procedures and adjuster training. It has performed this role since about 1915 in the hail business, and we find no lack of zeal to assist in multiple peril claims work.

See comment 15.

The companies also operate, through their statistical organization (CHIAA), a most comprehensive computerized audit and screening of MPCI business. This function has been in place since 1981 (borrowing from more than 30 years of such activity in the private hail arena). USDA's OIG has twice observed this process which compares favorably with that of FCIC.

We also note that FCIC does have a systematic method of recovering overpayments. The collection process can be a matter of simply off-setting against amounts routinely due the subject company from expense payments or/and reimbursement for losses paid. As we have noted, the process of collection is not at the root of the disputes; the identification of errors, and the amount of money involved, is.

FCIC has initiated actions on companies found to be in non-compliance and has demanded monies on identified overpayments, acting in good faith and being responsive to company rebuttals and appeals. We have served notice of recovery requirements on the company identified as put on suspension. This includes findings generated by the GAO. FCIC has been careful to allow the company its full dispute rights under the Reinsurance Agreement. Another company with multiple reviews in error has been notified of the findings and that FCIC expects corrective action. GAO also identified a reinsured company agent involved in possible forgery and other discrepancies on policies. This does not necessarily constitute claims overpayments, but rather errors in validation of policies written at the agent level for which policyholders may in good faith be jeopardized. We are pursuing this matter and will take appropriate action.

Relative to specific recommendations to the Secretary of Agriculture:

1. We have initiated development and publication of guidelines for improving the quality of the loss adjustment activities of the reinsured companies and the associated training program for loss adjusters. (See Appendix VI)

2. We are well along in implementing a comprehensive and systematic program of monitoring the effectiveness of company operations. The Compliance Division will, this fall, complete its first round of company reviews and will have established an audit routine which will, as suggested, recalculate randomly selected claims.

3. Since FCIC has already implemented a systematic and comprehensive monitoring and evaluation system for reinsured company compliance to both administrative and claims procedure, we contend there is no need to require claims files be submitted for review. Further, such a requirement, based on the 1986 figure of 84,000-plus proofs of loss, would increase personnel costs by an estimated $2 million, in addition to logistical and storage costs and complications. Computerized audits and screening, in addition to focusing on companies found to be operating below standards, will be sufficient to assure performance.

4. On the matter of establishing internal data processing controls we note that GAO seems to assume that nothing has been done in this area. We attach, at Appendix VII, a copy of the audit routines which have been applied since 1981.

5. FCIC will develop a revised system of administrative and operational tolerances which correspond to those of other related agencies. Following that action, FCIC will further refine the guidelines for determining when and what administrative actions will be taken in the event of violations of policy and procedure.

6. FCIC accounting practices and other tracking systems, for recovery purposes, are now functional and will soon be formalized in published procedure.

7. Handicapped by a lack of official information on a case basis, FCIC has nontheless begun the process of reviewing and reconciling differences in the responses of companies to GAO findings where known. As information from GAO is received, analyzed, and reconciled, FCIC will recover any overpayments. Indeed, notice was served on August 11, 1987, on one company which accounted for a substantial portion of the overpayment dollars identified by GAO.

8. As noted earlier, an analysis of drought cause of loss in the indemnification of irrigated crop losses is continuing. As indicated, overpayments identified will be pursued.

The following are GAO's supplemental comments on FCIC's letter dated August 25, 1987.

GAO Comments

1. Regarding actions FCIC is taking to improve the effectiveness of reinsured company operations, FCIC commented that it has inserted several provisions in the 1988 Standard Reinsurance Agreement—the contractual agreement between FCIC and reinsured companies—placing greater oversight and control requirements on the companies. These include (1) providing FCIC with authority to perform the loss adjustment function for poorly performing companies, (2) establishing explicit prohibitions against conflict of interest situations between loss adjusters, agents, and producers, (3) establishing requirements governing FCIC's recovery of overpayments, and (4) requiring that language be added to all policies informing policyholders of their responsibilities and those of reinsured companies and FCIC. In addition, the provisions of the 1988 Standard Reinsurance Agreement require companies to provide more detailed documentation and information on their operations for FCIC review prior to FCIC's approving the agreement.

We believe that the provisions added to the 1988 Agreement will provide FCIC with better oversight capability and will provide reinsured companies with a clear understanding of FCIC's expectations in the loss adjustment area. As such, we believe that, if properly implemented, they should help to improve the effectiveness of FCIC's oversight and control function.

2. In its "General Comments" FCIC expressed a concern about the tone of the chapter. Specifically, FCIC said that we repeatedly imply that the errors we discovered were so egregious that they suggested a willful attempt to defraud the government. In this regard, FCIC commented that we did not support our concerns that the claims were fraudulent and that, in fact, the probability that we found a pattern of fraud in such geographically disparate locations is unlikely. FCIC concluded this point by commenting that a company's lack of attention to internal oversight is not an intent to defraud.

We believe FCIC's comments are somewhat overstated and, as such, mischaracterize our report. The only place in the report where we discuss the possibility of intentional overpayments—fraud—is in the chapter where we discuss the types of errors we found. (See p. 25.) In that context we state that of all the 134 claims we reviewed, many of them had errors that were so blatant they seemed to have been intentional. On the

basis of this, we made clear in the report that we worked with the USDA/OIG and the Department of Justice to determine if any of the cases should be further investigated. Nowhere do we say that fraud actually took place—only that it may have occurred in some cases. Finally, regarding FCIC's point that we do not support our concerns about possible fraudulent payments, we will let the proper investigative authorities decide the final disposition of each case. We referred the cases to these authorities not because we thought we proved that fraudulent acts were committed but because our evidence showed that fraud might have taken place.

3. FCIC commented that our comparing the 31-percent overpayment rate for reinsured companies with the 1-percent overpayment rate for master marketer claims may not be a good indicator of loss adjustment problems. FCIC suggested that a better comparison would require audits of claims of comparable value.

We do not agree with FCIC's comment. The loss adjustment process is the same regardless of the size of a claim. Therefore, there should be no relationship to the size of the claim and overpayment rates. Further, our comparison uses relative numbers—31 percent versus 1 percent. As such, it factors in any disparities in the values of the claims.

4. FCIC also commented that much of our analysis of reinsured company claims was based on the work of two companies and that FCIC is taking disciplinary action against one of the companies and is conducting a special review of the other as a result of our findings.

FCIC is correct in its comment that much of our analysis was based on the work of two companies. However, this condition was coincidental to the methodology we used. Essentially, we focused our work on (1) the particular crops that received the most claims payments, (2) the largest payments, and (3) geographic disparity. The two companies referred to in FCIC's comments happened to have a large number of claims that fell under our criteria. Nevertheless, FCIC's action to improve the situation we found at these two companies is commendable.

5. FCIC commented that the overpayment rates of reinsured companies are not as bad as our analysis shows. FCIC said that when two claims are not considered the overpayment rate did not exceed 10 percent. In the two cases involving large overpayments, the companies are disputing our findings.

Overall, we found a 31-percent overpayment rate on reinsured company claims we reviewed. The fact that two of the larger ones are being disputed by the involved companies does not detract from the merit of our findings or conclusions. Further, FCIC'S own expert loss adjusters assisted us in the analysis of these claims and certified the amount of the overpayment.

6. FCIC further commented that because of the complexity and the judgmental factors associated with the loss adjustment process, there may be disputes between our findings and reinsured company determinations. As a result, FCIC plans to analyze each claim we reviewed on a case-by-case basis before making final determinations. According to FCIC, this process will begin as soon as we provide it with the details of the cases we reviewed.

The details on all our individual case studies were provided to FCIC on October 1, 1987. We encourage FCIC to pursue the resolution of any disputes as quickly as possible.

7. In commenting on our findings for the master marketer claims we reviewed and on its own review process for these claims, FCIC noted that even after going through its review process, any disallowed or reduced claim payments can be and are disputed. In fact, many are eventually litigated. As a result, FCIC asserts that the frequent and costly litigation it experiences on its master marketer claims is something reinsured companies cannot afford to sustain. Accordingly, FCIC believes that the potential threat of litigation that overhangs the loss adjustment of its claims—and presumably reinsured company claims—coerces settlements of disputed claims.

With this comment FCIC appears to be saying that the threat of litigation is a guiding force in its approach to settlement of disputed claims. However, we see no link between this point and the proper adjustment of loss claims. While litigation may be an eventual outcome of any claim dispute, we believe that, under any circumstances where FCIC—or a reinsured company—is adjusting a claim, it is imperative that the work be done in accordance with applicable policies and procedures and that a claim be disallowed, reduced, or increased on that basis. The threat of litigation cannot be an excuse for not following proper procedures.

8. FCIC noted that a new infrastructure over the claims review process was created as a result of a January 1987 study. The net effect of the new system is the creation of full-time claims specialists operating from

Area Claims Offices. The new group will review all claims prior to processing and will coordinate the training and quality assurance processes in each region. FCIC plans to have this new office review the effectiveness of loss adjustment operations in each region on a continuing basis.

We have no basis for determining whether the new system will improve the effectiveness of the process now being used. We do point out, however, that we found that the existing process was effective. Accordingly, to the extent the new process described by FCIC incorporates the same supervisory oversight and controls in place during our review, it should be at least as effective as the existing system.

9. FCIC commented that its internal processes and those of reinsured companies include procedures for performing edit checks of claims submitted for payment. FCIC comments state that additional edit checks are being added to its claims processing procedures that would preclude the kind of problems we identified—where payments were made for drought as the cause of loss on irrigated land.

We commend FCIC for its efforts in this area and encourage management to implement the new edit checks as soon as possible.

10. FCIC commented that our portrayal of claims involving drought on irrigated land as overpayments. Specifically, FCIC commented that it was concerned that we placed repeated emphasis on the payment of certain drought losses and questioned our implication that there were some $18 million in wrongfully paid claims for crop losses due to drought on irrigated land.

We disagree with FCIC's characterization of our report on this point. Nowhere in the report do we state that the roughly $18 million in claim payments cited by FCIC were incorrect. In fact, we consistently characterize the payments as "questionable." Until further investigative work is done by FCIC that could show, for instance, that the cause of loss was simply due to an administrative data entry or coding error, we believe that the subject payments must be questioned. It seems to us since FCIC's policy clearly precludes payment for losses due to drought on irrigated farmland, such review by FCIC is prudent management.

11. In its comments FCIC further states that a preliminary review of the claims in this category indicates that there were not improper payments made but, rather, erroneous loss codes entered on the claim data. In

other words, the administrative coding on the claims indicated that drought was the cause of loss when, in fact, it was not. Nonetheless, FCIC said that it has begun to review each of its claims for 1984, 1985 and 1986 where payments were made for losses where drought was cited as the cause of loss on irrigated land.

FCIC's efforts in reviewing each claim for 1984, 1985, and 1986 are appropriate to ensure that no overpayments were made and to get reimbursed for any claims that were overpaid.

12. In commenting on the section of the chapter captioned "FCIC Has Only Recently Begun to Systematically Review the Operations of Reinsured Companies," FCIC acknowledged that its oversight of the operations of reinsured companies was not a major part of its program for many years. Essentially, according to FCIC, it relied on the reinsured companies to police themselves. FCIC began to move toward a more formal oversight role in 1985. Initial staffing for what is now the compliance division began in April 1986; the majority of staff was hired in August 1986.

In our report we made it clear that FCIC established the compliance division in August 1986—5 years after it began to use reinsured companies as a crop insurance delivery system. From this, we assert that FCIC has only recently begun to act to systematically review the operations of reinsured companies. FCIC's comments on this point imply that it had begun to move toward formalized oversight prior to August 1986. In fact, FCIC did begin to move in that direction prior to August 1986. However, the compliance division, with staff assigned to oversee reinsured company operations, was not established until August 1986, as we state in the report. Prior to that time, the staff FCIC had devoted to reviews of reinsured companies did not perform any oversight function by systematically monitoring the activities of the companies. Rather, it primarily did sporadic reviews of whistle-blower complaints on specific claims.

13. FCIC mentioned several actions, in various stages of completion, that will help provide more effective oversight of reinsured companies. Some of these actions are aimed at improving the effectiveness of the compliance division, and some are aimed at improving the effectiveness of reinsured companies.

Regarding the work of the compliance division, FCIC commented that it (1) has recently issued a Compliance Handbook to help ensure systematic reviews of reinsured companies, (2) has begun to formalize procedures for the systematic tracking and collection of overpayments identified by its staff and others, (3) is developing a data base that contains the status of all case reviews and related findings, (4) is developing a tracking system to monitor compliance reviews of reinsured companies, actions taken to correct identified problems, and follow-up on actions taken by reinsured companies, (5) hopes to complete reviews of the loss adjustment activities of all reinsured companies by October 1987, and (6) is currently reviewing all reinsured companies' activities to determine whether they are effectively verifying the actual production history of policyholders. In addition, FCIC noted that it has recently requested several OIG investigations resulting from its oversight activities and that several loss adjustment bulletins have been issued to companies advising them of potential problem areas or required changes in loss adjustment practices as a result of its review and oversight activities.

We believe the actions mentioned by FCIC are positive steps which, when completed and implemented, will improve the effectiveness of its oversight function and control.

14. FCIC also reiterated that it has placed additional requirements upon reinsured companies in the areas of adjuster training and supervision and quality control functions. In addition, FCIC notes that the principal trade association for crop insurance loss adjusters provides training to adjusters.

The measures being taken in this area are positive steps. However, in our opinion, until FCIC requires reinsured companies to pattern their adjuster training, supervisory review, and quality control programs after FCIC's rigorous program for master marketer claims, we do not believe FCIC's actions will be as effective as they could or should be. Our review has demonstrated the comparative effectiveness of FCIC's program for master marketers. Under the approach being taken by FCIC, reinsured companies still have a great deal of discretion in implementing those activities. As such, they may or may not be effective.

15. FCIC commented that the computerized claim audits and screening done by CHIAA for the reinsured companies is a good one and compares favorably to the one used by FCIC for its master marketer claims.

We have no problem with this comment. However, as our report demonstrates, the process can be improved. If FCIC had in place a computerized edit check for reinsured company claims like those used for master marketers, many, if not all, of the $17.9 million in claims paid for drought on irrigated land would have been identified, and presumably checked out, before they were paid. FCIC apparently agrees with our assessment since, as noted on page 7 of the comments, it is now in the process of adding several new edit checks to the computerized audit routines of CHIAA and FCIC.

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